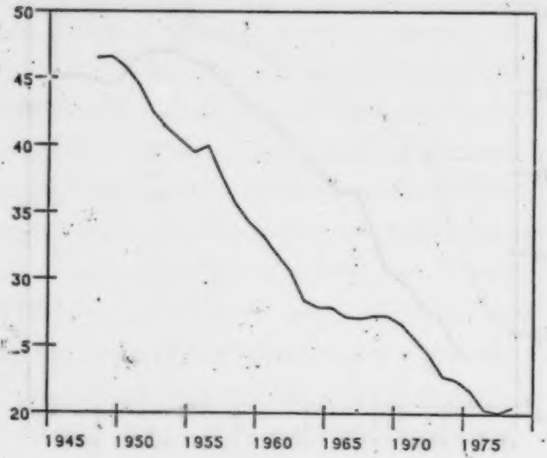
CHART III

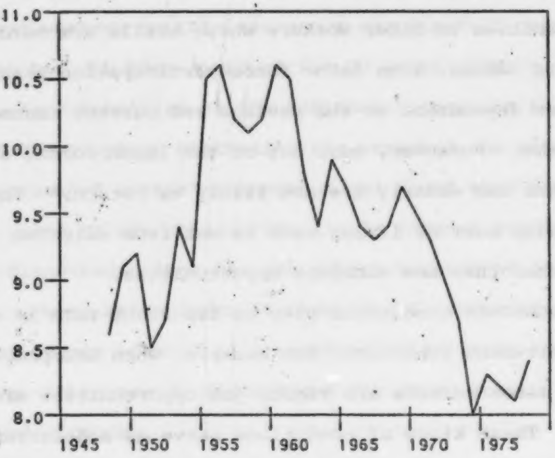
LABOR FORCE PARTICIPATION RATES
MEN 65 AND OVER



Source: Inflation and the Elderly - Part II, report prepared by Data Resources, Inc. for NRTA/AARP. January 1980

CHART IV

LABOR FORCE PARTICIPATION RATES
WOMEN 65 AND OVER



Source: Inflation and the Elderly - Part II; report prepared by Data Resources, Inc. for NRTA/AARP. January 1980

Fewer elderly participate in the labor force for a variety of reasons. These include their own choice for greater leisure, the growth of government income support programs, institutional rigidities about retirement, discrimination against older workers and a changed industrial structure affording fewer job opportunities to older workers whose skills are outdated. Whatever its causes, less labor force participation translates into greater dependence on the savings and current income support programs. Moreover, once out of the labor force, studies indicate that the elderly are not likely to return.* Therefore, a rising cost of living must be met from existing income sources rather than new earnings opportunities.

Macroeconomic conditions play an important role in affecting retirement behavior. For example, when unemployment is low and labor markets are tight, job opportunities are plentiful. These kinds of conditions serve as a deterrent to retirement and may even induce some workers to come out of semi-retirement and return to the labor force. On the other hand, when unemployment rates are high, not only are job opportunities limited but many workers are laid off from their jobs due to depressed demand. Since alternative jobs are difficult to find for the older worker, many of them will opt for retirement once unemployment benefits run out. This amounts to a form of involuntary retirement.

Despite the new recognition that what goes on in labor markets is important to older persons and to the retirement

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*Grad, Susan. "New Retirees and the Stability of the Retirement Decision," SSA Bulletin, March 1977.

systems that serve them, those markets do not perform particularly well for this segment of the population, especially the unemployed older worker. In 1977 unemployed workers 45 years of age or older remained out of work an average seven to ten weeks longer than their younger counterparts. In that year, unemployed workers in this age group comprised 22 percent of those who had not been employed for 27 weeks or more.

Dr. Marc Rosenblum of the National Commission on Employment and Unemployment Statistics has measured the extent of the "discouraged worker" phenomenon and found that persons over 55 years of age contain the single largest population of persons discouraged from the job search because of job market reasons. Among males under 55 there are 4 discouraged workers for every person counted as unemployed while among those 55 and above, there are 37 discouraged for every person in the unemployed category.

The other major macroeconomic factor which can potentially have significant effects on labor force participation rates is inflation. The labor market effects of inflation are not as easily measured as those of recovery or recession. There are two reasons. First, sustained, high levels of inflation are only recent. This limits the amount of data available to study the phenomenon. Second, our society has adopted various forms of indexation which, to some degree, protect individuals from the adverse effects of inflation, both in the labor force and in retirement.

In a world without indexation, inflation would act as a strong deterrent to the election of retirement. Inflation also raises greater uncertainty about the future. Being unsure about the future real value of retirement income, a worker may prefer to remain in a full-time employment to hedge against the undesirable effects of inflation. As long as he is working, he is relatively protected from inflation, since over time wages tend to keep better pace with inflation than other forms of retirement income. Also, by working longer, individual retirement benefit levels are usually increased. Although higher benefits do not mitigate the effects of inflation, they do provide an added measure of income protection.

Much of the labor force participation trend which has been described took hold before inflation rates of today became embedded in the structure of the economy. We believe the early retirement trend will begin to decline during the present inflationary era. A recent Harris survey of retired employees found that 53% of that group said they wished they had never retired in the first place, but had continued in some kind of employment. A nation-wide poll of persons 55+, conducted by the Washington polling firm of Hamilton and Staff for our Associations, found that half of the retirees in the group retired by choice. However, a significant 36% of the retirees said they would rather be working and among the respondents still working, 62% were glad of it while 21% said they would rather retire if they could afford it. Another survey of corporate personnel directors (publicized in the October 29, 1979 Wall Street Journal) showed that 88% of the directors believe inflation and the problems of living on fixed incomes will reduce the number of employees retiring before age 65 to 70.

What is important to recognize in examining these trends
s the fact that more and more older persons, at earlier ages,
re becoming dependent for income on sources other than employ-
ent and that this trend is accelerating. Table I on the
ollowing page demonstrates this trend. For all four age
roups, income from employment declined in importance over the
en-year period 1967-1977 while the share of income from assets
ncreased. Table II demonstrates the particularly high degree
f dependence of low-income persons on public transfer pro-
rams and their lack of wage and salary income. This situa-
ion causes this income group to be most vulnerable to inflation.

Given what we hope will be a national commitment to the
aintenance of reasonable levels of income among the elderly,
ny share of that income can be generated through the work
ffort of willing older persons represents a share that need
ot be borne by public programs and younger taxpayers who
upport them. Clearly, additional work opportunities benefit
lder individuals as well, raising their standard of living,
roviding them with a greater feeling of independence and
elf-determination and improving their prospects for main-
aining their living standard in the face of serious infla-
ion. Just as clearly, the nation as a whole would benefit
rom the gains in national income and tax collections that
ould result from our getting the most from our previous in-
estment in the training, education and experience embodied
in older persons.

TABLE I

INCOME SHARES BY SOURCE

	1967	1977
Age 55-61		
Wages and Salaries	76.6	70.9
Social Security	1.6	3.1
Asset Income	5.2	7.6
All other	16.6	18.4
Age 62-64		
Wages and Salaries	67.3	50.0
Social Security	7.6	15.3
Asset Income	7.9	11.3
All other	17.2	23.4
Age 65-71		
Wages and Salaries	34.3	20.9
Social Security	27.6	38.0
Asset Income	14.2	17.0
All other	23.9	24.9
Age 72 & over		
Wages and Salaries	10.9	5.7
Social Security	43.0	48.3
Asset Income	19.5	22.9
All other	26.6	23.1

Source: Inflation and the Elderly - Part II, report prepared by Data Resources, Inc. for NRTA-AARP, January, 1980.

TABLE II

SOURCES OF INCOME FOR CONSUMERS AGES 55 & OVER
IN 1976 BY AGE OF HEAD

SOURCE: MARCH 1977 CPSAUF - FAMILIES FROM PERSONS

	UNDER $5K	$5K TO $10K	$10K TO $15K	$15K TO $20K	$20K TO $25K	$25K & OVER	ALL INCOMES
COUNTS......................	8,521.25	7,032.73	4,098.30	2,880.97	1,782.73	2,762.39	27,078.37
MEAN PRE-TAX INCOME ($)....	3,087.32	7,171.58	12,260.06	17,205.59	22,105.02	36,564.32	11,712.13
WAGES & SAL. (%)...........	10.75	25.76	48.81	61.91	70.77	68.17	35.66
NONFARM SELF EMPL. (%).....	0.70	2.32	3.74	4.64	4.97	8.11	3.04
FARM SELF EMPL. (%)........	0.79	1.37	1.90	1.47	1.31	2.48	1.38
SOCIAL SEC. & R.R. RET. (%)	64.61	41.46	18.72	9.84	5.78	3.25	35.69
SUPP. SECURITY (%).........	8.07	1.51	0.30	0.10	0.14	0.04	3.01
INTEREST (%)...............	4.56	7.65	7.60	6.31	4.57	5.76	6.13
DIV. RENT & TRUST (%)......	0.27	3.67	3.91	4.61	3.62	6.00	2.98
WELF. & PUB. ASSIST (%)....	2.76	0.61	0.29	0.12	0.12	0.03	1.10
UNEMPL. & WKMNS COMP. (%)..	4.09	3.42	2.79	1.94	1.58	0.71	2.98
PENSIONS (%)...............	3.35	11.78	11.33	8.72	7.05	5.11	7.74
OTHER (%)..................	1.08	0.63	0.78	0.36	0.33	0.31	0.71

Source: *Inflation and the Elderly* - Part II, report prepared by Data Resources, Inc. for NRTA-AARP, January, 1980.

COMPONENTS OF AN OLDER WORKER EMPLOYMENT STRATEGY

In view of all of the trends previously described, it should be apparent that government policies which create incentives for early labor force withdrawal are imposing serious and unnecessary costs on our economic system and are making it more and more difficult for older persons to maintain adequate standards of living in their later years. An appreciation of the long-term consequences of these trends should prompt a response. Our Associations feel that the best response is not to raise the social security "normal" retirement age but rather to revise government policies which encourage idle retirement and at the same time to develop a strategy for providing increased job opportunities for older persons. We believe such a strategy would partially obviate the future need for increasing payroll taxes or cutting social security benefits.

A 1978 Urban Institute Study entitled The Aging of America: A Portrait of the Elderly in 1990 and authored by Richard Werthimer and Shiela Zedlewski helps to reinforce our contention. This study assumed certain changes in the social security benefit structure--namely, a small decrease in early retirement benefits, a small increase (from 3 to 5 percent) in the delayed retirement credit and a slight liberalization in earnings limit (achieved by decreasing the benefit reduction rate from 50 to 40 percent). With these assumptions (in addition to assumptions for adequate economic expansion), the authors suggest that costs and tax rates of the social security program would be lower (despite the liberalizations) than they otherwise would be and, at the same time, projected income levels of the elderly would be 12 to 38% higher as a result of their increased earnings. The authors stated, "The major conclusion of this study is that it may be possible to reduce the tax burden on the working population and increase the income going to the elderly, through changes in the retirement incentive structure to delay retirement." (p. 2)

The first necessary step in beginning to effect an older worker strategy is to eliminate the social security earnings limit.

I. NEED FOR ELIMINATION OF EARNINGS LIMIT

One of the key elements in changing social security so that it can accommodate future trends, is the elimination of work disincentives which exist in the program. Chief among these, in our Associations' view, is the social security earnings limitation. Our Associations want it abolished, not because we are insensitive to social security's financing problems, not because we are iconoclastic about the "social insurance" nature of the system, and not because we favor elderly "fat cats", but because we firmly believe that, as an economic matter, the earnings test is costing society more than it is worth and will cost even more in light of future economic and demographic trends. In addition, the elderly detest it.

Given this country's historical predisposition to work ethic and the fact that the only income-related means test imposed by the social security system is on earned income, it ought to be clear why the test is so unpopular among the elderly and why it is so frequently the target of Congressional proposals. Opposition to removal of the test also rests on a number of arguments.

A. Cost Argument

First, it is argued that abolition of the test would be costly to social security, which is already under severe financial strain. Some estimates have put a price tag on complete elimination of the earnings test (for persons over age 62) at as high as $7 billion dollars in increased social security outlays. More recent Social Security Administration estimates indicate $2.1 billion in additional outlays if the test is repealed for persons 65+ in 1982. This cost argument ignores how much the test now "costs" the overall economy in terms of lost production. Unfortunately, we have no official estimates of this figure. However, we have calculated that if only one million older persons re-enter the labor market on a part-time basis, even earning at the minimum wage, the increase in gross national product that would occur would exceed the $2.1 billion that the Social Security Administration recently estimated would be the annual "cost" of repealing the test for persons age 65 and over.

In addition, this argument ignores the "cost" of lost income and payroll tax revenue to federal, state and local governments. Table III on the next page outlines estimates made by Senator Barry Goldwater and economist, Marshall Colberg,

TABLE III: ESTIMATED INCREASE IN TAX REVENUE FROM ELIMINATION OF EARNINGS LIMITATION

(In millions of dollars)

	Payroll Tax	Income Tax	Total
GOLDWATER ESTIMATES[1]			
High estimate:			
Men	$812.7	$192.0	$1,004.7
Women	279.5	29.7	309.2
Total	1,092.2	221.7	1,313.9
Low Estimate:			
Men	632.8	144.0	776.8
Women	209.6	22.0	231.6
Total	842.4	166.0	1,008.4
COLBERG ESTIMATE[2]			
Men	141.7	138.6	280.3
Women	97.7	75.7	173.4
Total	239.4	214.3	453.7
SSA ESTIMATE[3]			
Total	678.6	977.8	1,656.0

[1] Source: Statement by Senator Barry Goldwater, Congressional Record, Nov. 4, 1977, p. S 18756.

[2] Source: Marshall Colberg, "The Social Security Retirement Test: Right or Wrong" (American Enterprise Institute, 1878). pp. 54-56

[3] Source: Gordon, Josephine G. - Shoeplein, Robert N., "Tax Impact from Elemination of the Retirement Test", Social Security Bulletin, September 1979.

regarding the increases in payroll and income tax revenue which would result from elimination of the earnings limit. These estimates indicate that increased tax collections could partially offset the increased cost of eliminating the limit.

Recently, an important article on this subject was published in the September 1979 Social Security Bulletin. This article is entitled "Tax Impact From Elimination of the Retirement Test," and is authored by Josephone G. Gordon and Robert N. Schoeplein of the Office of Research and Statistics, SSA. This study concludes that elimination of the retirement test for workers age 65-69 would generate an additional $678.6 million in payroll taxes and an extra $977.8 million in federal individual income taxes. This additional revenue, when combined ($1.656 billion) would offset 79% of the $2.1 billion SSA has estimated it would cost to repeal the test. We believe these findings are significant and lend weight to our Associations assertion that the test is costing society more in terms of lost tax revenue and contributions to the GNP than it would cost to repeal it.

A great deal of controversy surrounds the issue of how much additional revenue would be generated by elimination of the test. In order to estimate the revenue effect, judgments must be made as to how the elderly would respond to elimination of the test--by how much would they increase their work effort, would many of them who would have elected full retirement at age 65 choose to remain at their jobs full time? These questions are difficult to answer in a concrete manner since we do not know precisely what the elderly's response to elimination of the test would be. Their response would obviously be affected by various economic factors; high unemployment would make it difficult for older workers to maintain their jobs or seek new ones while high inflation would induce many older persons to seek wage income to protect their income status. Given this situation, policymakers must simply make an informed judgment about the elderly's response. We are convinced, along with other economists, that the response would be significant and large enough to offset a large portion of the "cost" of eliminating the test.

Some economists (like Cagan* and Pellechio**, for example) have argued that the response of older workers would not be significant and that less than 20 to 30% of the cost would be offset. However, their studies make a crucial assumption, that is that removal of the test would not affect the decision to retire. Our Associations are convinced that removal of the test for persons age 65+ would indeed induce many to delay their retirement. This assertion is borne out by research done by another economist, Michael Boskin.***

The "cost" question has prompted a variety of proposals to change the existing test without actually removing it so that any large additional cost is avoided. For example, Peter Diamond has suggested that the present retirement test be retained while a portion of social security benefits are exempted from the test. The portion of benefits exempted would rise with age starting at 15% at age 65 and growing to 100% at age 70. Our reaction to the Diamond proposal is negative. It would be extremely complex to administer (let alone explain to beneficiaries) and, most important, it would have a very slight impact on the initial decision to retire at age 65. If Congress is going to liberalize the test in any manner, those liberalizations ought to focus on affecting the initial retirement decisions and encouraging older persons (especially those in the age 65-68 age category) to increase their work effort. It appears to us that the incentives in the Diamond proposal are somewhat distorted.

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*Phillip Cagan, "How Much Would the Removal of the OASDI Earnings Test Increase Employment and Tax Revenues," memo to Panel Actuaries and Economists, August 6, 1974.

**Anthony J. Pellechio, "The Social Security Earnings Test, Labor Supply Distortions, and Foregoing Payroll Tax Revenue," National Bureau of Economic Research, Working Paper No. 272.

***Boskin, Michael J. "Social Security and Retirement Decisions," Economic Inquiry, Vol. XV, No. 1, January 1977.

Although we consider elimination of the test to be an essential first step toward a comprehensive restructuring of social security, we realize that "cost" arguments may prevail given the current social security financing difficulties. For this reason, we support elimination of the test at this time only for persons age 65 and over. This is an appropriate first step since repeal of the test for persons under age 65 could have perverse effect of encouraging early retirement. In this same spirit of incrementalism, we would support a phasing-in of the elimination of the test by making ad hoc increases in the exempt amount. This approach, unlike some others, would be clearly perceived by beneficiaries as an inducement to increased work.

One phase-out option could be to make ad hoc increases n the exempt amount beginning in 1983 for persons 65 to 70 ears old. Under present law, the earnings ceilings for older ocial security beneficiaries--now $5,000 a year for individuals 5 to 71 years old--is scheduled to increase by $500 a year ntil it reaches $6,000 in 1982. In addition, the upper age imit for the test will be reduced from 72 to 70 in 1982. hereafter, the exempt amount will rise proportionately in ccordance with the average covered earnings under the program. ased on the most recent estimates, the exempt amount for beneiciaries 65 to 70 is projected to rise automatically after 982 as follows:

1982	$6,480
1984	$7,080
1985	$7,800

ource: Social Security Administration)

Under one possible option, the exempt amount could be ased out for older persons according to this plan:

1983	$7,000
1984	$8,000
1985	$9,000
1986	Eliminated for beneficiaries 65 years or older

This would minimize any possible "cost" impact on the stem, and that possible impact would be postponed until 1983. ring this time the Congress will have an opportunity to rengthen social security financing.

B. Change Nature of System

The second major argument advanced in opposition to eliminating the test is that such a change would, in turn, change the nature of the system from social insurance to an annuity payable at a specified age. Those who want the present nature of the social security program perpetuated view social security dollars as intended only for the "retired" and look upon the earnings limitation as the essential mechanism to determine who is retired and who is not. This attitude is short-sighted. Our Associations would argue that fundamental change in the nature of the system is precisely what is needed if we are going to avoid having it become overwhelmed by obvious demographic, economic and labor force participation trends. We believe social security must respond to these trends and be transformed into a system that is work-oriented--one whose benefit and financing structures encourage and reward work effort.

C. Benefit Distribution

The third major argument advanced in opposition to elimination of the test is the "fat cat" or benefit distribution argument. Removal of the test would appear to benefit disproportionately those elderly persons in relatively high income brackets--a not too surprising result in view of the fact that social security is an earnings-related system. Other things being equal, persons with a higher earnings capability are more likely to encounter a test based on earnings levels and are also more likely to have accumulated a higher level of wealth, including social security wealth, over their lifetime.

More importantly, however, there is a large group of hidden beneficiaries who are of relatively low income that the supporters of the earnings limit choose to ignore. The studies that have been done clearly document the fact that large numbers of low income working elderly deliberately hold their earnings down and drop out of the labor force rather than bear the high tax rate that the test and taxes impose on excess earnings. Since these people do not actually have their social security benefits reduced, they are not counted as potential beneficiaries of eliminating the test. Hence, although the distribution of additional social security dollars would still go to the relatively well off, the distribution of the total economic benefit from earnings test abolition would certainly be less skewed in favor of the well-to-do than is presently thought.

Those who would retain the test would rather channel the billions in additional outlays (that the elimination of the test would entail) to low income, non-working older persons. We would argue that this "alternative" of allocating the additional measure of social security resources to the "right" people has no potential economic gains associated with it and is in a sense more costly and highly unlikely to be undertaken because of the additional cost to the system entailed. This line of argument seems more appropriate to an income-tested welfare program rather than one based on "earned right" and earnings related benefit levels. Our Associations restate again that the only income test in social security is the

earnings test--a test aimed only at earned income.

D. Fixed Number of Jobs

Finally, although the argument is rarely made explicitly, the earnings test is defended as a means of improving the employment prospects of younger workers. This reasoning reveals a belief that the earnings limit opens up positions for younger workers and keeps the retired from re-entering the labor market to compete for jobs, perhaps offering their services at lower than market rates. In our opinion, this theory is incorrect. The economy has been able to accommodate an increased number of workers in the past, especially women, and it should be able to do so in the future when our population will contain proportionately more older persons.

I. ADDITIONAL SOCIAL SECURITY INCENTIVES REQUIRED

In addition to repealing the earnings limit gradually, ther changes within the social security system are needed o help reverse the elderly's declining participation in the abor force and to reduce their degree of dependency on public rograms for income maintenance. Additional work incentives ithin social security need to be created for two reasons. irst, they are needed to counter the strong work disincentive hich exists in the current procedures used to update wage ecords of workers who delay their retirement date past ge 65; and second, once the test is eliminated, added incen-ives will be needed to keep older persons fully working and ff the social security rolls.

With regard to the first point concerning benefit omputation procedures, it appears that the manner in which age records are indexed under the new decoupled indexing rocedures works to strongly disadvantage persons who delay heir retirement date. The new indexing procedures resulting rom the 1977 legislation can substantially reduce the eneficial effect of continued work on the retiree's eventual enefit amount because during the process of calculating a orker's AIME, the worker's earnings records are updated (or ndexed) only up to the year in which the worker reaches age 0. For work after that year, earnings records are not indexed, ut used at their actual dollar value. Obviously, the longer the worker waits to retire, the more out-of-date his post-age 60 earnings records will be and the less influence those continued earnings will have on increasing his eventual benefit amount.

Regarding the second point concerning the need to provide strong incentives for older persons to work and delay their retirement date in the context of repealing the earnings test, our Associations recommend a substantial increase in the delayed retirement credit -- at least to the actuarial level of approximately 7 to 8%. Under present law, individuals who elect not to receive social security benefits because they continue working beyond age 65 are entitled to a 1-percent bonus for each full year of delay between age 65 and 72. In 1977, Congress raised the delayed retirement credit to 3-percent per year for people who become 65 in 1982. We believe this 3% bonus, however, does not provide sufficient encouragement for individuals to work beyond 65, nor does it compensate the older worker for the adverse indexation procedures described above.

If Congress decides to eliminate the retirement test, this 3% credit would certainly not be large enough to cause older workers to delay filing for benefits since with repeal of the test they would be able to work and receive full benefits at the same time. We believe an actuarially-related delayed retirement credit, however, would provide a reasonably strong incentive for older persons to elect to delay receiving benefits. And raising the credit to an actuarial level in the year the test is repealed would entail relatively low costs. These costs would be far lower than they would be if the credit were raised before eliminating the test.

Therefore, to reverse the elderly's declining labor force participation and early retirement trend, our Associations recommend that two major changes be made in the social security benefit structure: elimination of the retirement test and raising of the delayed retirement credit to at least an actuarial level. These two changes should be linked together so that we can encourage more older persons to work and at the same time give them a reasonably strong incentive to delay receiving full benefits.

In the long run, work incentives through social security will benefit the system given predicted demographic trends. This incentive approach to dealing with the demographics is clearly preferable to such drastic measures as raising the age to 68 for receipt of full benefits. And in the short run, our nation will benefit from the skills and productive capacity of older persons as well as from the additional revenue and growth in GNP their work effort will generate.

III. OTHER STEPS NEEDED OUTSIDE THE SOCIAL SECURITY SYSTEM

One necessary element of our older worker strategy is the need to eliminate existing elderly employment barriers, the greatest of which is mandatory retirement.

In 1978, Congress enacted amendments to the Age Discrimination in Employment Act (ADEA) that prohibit mandatory retirement before age 70, with a few exceptions, and protect most federal employees completely against age-based retirement. However, these amendments do not go far enough. All statutory sanctions for forced retirement and the statutory exclusion of persons over 70 from the protection of the ADEA should be repealed.

Other factors exist which serve to discourage (or in some cases bar) work effort by older persons. One of these is age-based discriminatory employment practices which continue to exist despite the ADEA or which the ADEA specifically sanctions. ADEA ahould be amended to prohibit such practices.

Another objective of an older worker employment strategy should be the creation of new or the modification and/or expansion of existing government employment programs aimed at elderly workers. At present, there are only two such programs -- the Senior Community Services Employment Program (SCSEP), funded under Title V of the Older Americans Act, and the Comprehensive Employment and Training ACT (CETA) Program.

The SCSEP is the only categorical program focused exclusively on older workers. It provides a small number

(50,000) of part-time jobs for workers age 55 and over who have been chronically unemployed and are below the poverty level at program entry. This program emphasizes on-the-job training and placement of trained workers in permanent unsubsidized jobs.

A detailed SCSEP analysis by the Associations found that, after an average period of less than a year -- during which time the worker was being trained on the job and paid out of program funds -- the worker was likely to be hired permanently for the job and paid by the employer. Since these older workers would have received SSI and food stamps had it not been for SCSEP, it was calculated that these two programs saved $24 for every month a SCSEP worker remained unemployed. It was further calculated that a permanently hired SCSEP worker returned $1,039 more per year in tax revenue to all units of government than it cost in tax revenue to place the worker in a job. In addition, every permanently hired SCSEP enrollee produced $15,400 worth of economic output while in the program and after permanent hiring.

This cost-benefit analysis clearly illustrates the success of this program and demonstrates that it is in the nation's economic best interest to encourage older persons to work by creating and expanding special employment programs for them. As part of any older worker employment strategy, a nationwide, categorical, centrally directed

older worker program like the SCSEP should be created that would include full as well as part-time jobs.

The other primary vehicle for dealing with the employment difficulties of older persons is CETA. However, older worker participation in CETA has been well below what might be expected on the basis of the size of the older worker unemployed pool.

In an attempt to correct this situation, Congress added to the 1978 CETA Amendments an older worker section and an emphasis on displaced homemakers. These Amendments require prime sponsors to submit a comprehensive master plan and an annual plan which must describe specific services for those workers facing servere handicaps in obtaining employment, including those 55 years of age or older. Employment and training opportunities must be made available on an equitable basis to significant segments of the population.

The Amendments also require the Secretary of Labor to establish employment and training programs for middle-aged and older workers who are unemployed, underemployed or economically disadvantaged and whose family income is not in excess of 125 percent of the poverty level. All of this, however, may still not be enough to insure adequate participation of the elderly in CETA. Only a $2.6 million funding level was provided in FY 1980 for the middle-aged and older

worker program - a sum that will provide a mere 400 jobs. A budget request of $5 million was included in the Administration's request for FY 1981. These amounts are too small to really offset the older worker's need for improvement.

It is clear to us that barriers and economic disincentives that drive or discourage older workers out of the labor market must be eliminated and that work incentives and special employment programs aimed at older workers must be created or expanded. It is also clear, however, that these actions will still not be enough to maximize elderly labor force participation. Changes on the demand side (the employer side) are also necessary.

Employers need to be given incentives to employ and/or retain older workers. The federal tax structures ought to be used to provide such incentives (and at the same time provide incentives to older workers to take advantage of the work opportunities so offered). For example, the employer portion of the social security payroll tax that would otherwise have to be paid with respect to older workers could be reduced or eliminated. A tax credit for a certain portion of the older worker's income could also be used to encourage employers to hire them. Such changes would effectively reduce the cost of hiring older workers, compensating to some extent for any real or imagined productivity decline associated with age that an employer might otherwise entertain. These changes

would also tend to counter any disincentive effect that the minimum wage might have on an employer's willingness to hire or retain an older worker. In addition, the tax laws could be used to encourage employers to introduce a host of job training, retraining, part-time and flexi-time programs aimed at older workers.

Mr. BURTON. Thank you.

What do you think about the argument that it is really the high-income elderly who will benefit by the elimination of the earnings test? Do you subscribe to that?

Mr. WOODRUFF. Well, as I mentioned in my testimony, the Commission in dealing with that question felt that we needed to change the tax treatment of the social security system as well. Thus, by moving to a tax-deferral system, with the inclusion of benefits as taxable income, the Commission felt that we would not be giving benefits to the high-income people. They would have their benefits subject to normal taxation.

Mr. BURTON. Well, the wages if they are high income are subject to normal taxation. Do you believe an inordinate amount of this benefit will go to people who do not need it?

Mr. WOODRUFF. We felt not.

Mr. BURTON. Mr. Pellechio.

Mr. PELLECHIO. No. I——

Mr. BURTON. Your figures do not seem to indicate that.

Mr. PELLECHIO. You could look at the earnings distributions and say the effect of the earnings test is to split the distribution into two groups, those people earning the exempt amount or less, and those people who are earning the maximum taxable earnings or more and not collecting a benefit. You can take advantage of that splitting of the earnings distribution, by putting the exempt amount in the middle—that is, raise it a substantial amount to $12,000, $15,000—to benefit mostly the people below the exempt amount.

For high-wage people who continue to earn income, I do not know that it is wrong or incorrect in some way to pay them social security benefits. They paid payroll taxes at the maximum over their entire working career. And paying benefits to them is just their return on the payroll taxes that they paid. As the system has developed, we see people enter retirement, traditional retirement ages, after paying payroll taxes over an increasing portion of working life. So the perception of the system by individuals has changed as well. They look at it as an investment over their lifetime, where they pay payroll taxes and get their return in benefits. It is that lifetime perspective that justifies paying benefits to people who have paid in.

Mr. BURTON. Well, the argument is that if the money goes to somebody making 50 grand a year, it could be better paid to correct the current inequities and lift up those at the bottom. I think maybe they can do both.

Mr. **Pellechio.** In the last part of my written testimony I talk about the two major objectives that the social security program tries to achieve. One is to redistribute the person's own income over his lifetime to pay for his retirement support, and the other to redistribute income between people to provide socially adequate support. The redistribution between people should be done through general revenue, because that is where we do our income redistribution. That is the wisdom behind Senator Goldwater's recommendation about drawing on general revenue to pay this socially adequate benefit. He is looking at the income tax system as the proper system for doing that redistribution. And the wisdom is in addition that he is being clear that a careful calculation has to be done. We have to calculate precisely the cost of this redistribution between people and use general revenue in the proper place.

Ms. **Ferraro.** What this panel has done, I think, has reiterated several truths that have been heard all morning. One is that the earnings limit is a disincentive to the elderly to continue working. The other is that there are many people who are on social security who can use the extra money. In your testimony you indicated it will relieve interfamilial tensions in some instances because of the financial problems.

Your studies, Mr. Pellechio, indicated that the workers—by the earnings limit we are forcing people to keep their additional income to that level. But nonetheless, neither one of you addressed the fact that it is very costly to remove that earnings limit. In fact, in your testimony, Mr. Woodruff, you said that the net cost to the social security trust funds—liberalization must be carefully studied. What happens if you cannot get it out of general revenues, and it is going to have to come out of the trust fund? Would your Commission still support the elimination of the earnings test?

Mr. **Woodruff.** We have proposed a series of other tax changes, as I mentioned. The reason that our cost estimates would not be the same as Larry Thompson's testimony indicated this morning is that his estimates did not include these tax changes. We think that under our proposal there would be substantially more general revenue gains than indicated in the study, that I think Bob Schoeplein has coauthored, that they were making reference to.

Ms. **Ferraro.** You are also assuming the use of general revenues as part of the place where you get moneys to pay for this?

Mr. **Woodruff.** That is right.

Ms. **Ferraro.** But without that, if you were not able to get it from general revenues?

Mr. **Woodruff.** Well, we think there are probably even more substantive problems with the future financing of social security than even this one proposal indicates. I think the Commission might feel differently if there were not offsetting gains in general revenue or if other general revenue funds were not available. Because our conclusion is, which was underlined last week by the trustees' report of the social security system, the system has some very, very serious problems in the long run. It has some in the short run, but very serious problems in the long run.

Ms. **Ferraro.** The Schoeplein study seems to have been used by both panels in order to come up with your conclusions. And yet the approach to it is quite different than as given to us by the previous panel.

When Mr. Aaron testified, he said removing the retirement test for those over 65 would cost close to $2.1 billion in 1982. And then he said that there are ways of paying for this. And one of them was by going to the general revenue system. And he said that there were slim chances of that getting by. I kind of agree. I think it is a slim chance of something like that getting through this Congress. So he says as a practical matter the cost of removing or liberalizing the retirement test would have to be met by increasing payroll taxes or by reducing other social security benefits; are the benefits worth the cost.

Two questions: One: Do you agree that it would have to reduce other benefits? Two: If so, are the benefits worth the cost?

Mr. HACKING. Well, first of all let me say that the whole issue of eliminating the earnings test and how one goes about doing that ought to be considered in the proper context. Last Thursday the social security trustees released a report that sketched out a very grim future for the programs in the short term. Our associations have advocated and are continuing to advocate that the Congress redistribute the payroll tax revenue among the three funds served by the payroll tax mechanism for the purpose of shoring up the OASI fund. We want that done this year by this Congress in order to buy some time. We do not, however, think that redistribution would be a permanent solution to the short-term financial problems the system faces.

Ms. FERRARO. That is currently in Ways and Means.

Mr. HACKING. There was a markup of legislation this morning in the social security subcommittee and it was approved. That will buy some time. But, a I said, we do not think it will solve the short-term problem.

We think that the economic situation has been consistently underestimated. In other words, forecasters have been too optimistic with respect to the movements of prices and with respect to the rate of unemployment associated with the current recession. These things have direct and significant impacts on the benefit expenditure side of social security and on the revenue payroll tax side of the programs. We would want the next Congress, the new Congress coming in next year to take a close look at what are the causes of the short-term financial imbalances that seem to be arising every few years. After having looked at and analyzed the situation, we trust that the Congress will see the sense of utilizing limited amounts of general revenues on a temporary basis to compensate the cash benefit programs for the financial damage the programs suffer as a result of the economic evils of high-rate inflation and high-rate unemployment. Once our economic house is brought back into a reasonably stable state, and we have greater rates of real growth in GNP, lower rates of inflation, and a low and stable unemployment level, then I think that we shall begin to see an improving financial situation for the programs over at least the midterm.

Now, to the earnings-test issue. If you are going to put general revenues in, add a little more to begin phasing out the earnings test on a step-by-step basis for persons 65 and over, and let us watch what happens in terms of the effects on tax revenues.

Ms. **Ferraro**. Let me just make one comment. You are talking about taking from general revenues, and add a little bit more; $2 billion is a little bit more than a little bit more out of general revenues. But further than that, if you were unable to use general revenues, would you still consider this one of the directions that the Congress should go?

Mr. **Hacking**. We are not going to change what we are advocating.

Ms. **Ferraro**. I am asking you to prioritize for me. That is what I am asking you to do.

Mr. **Hacking**. It is difficult for me to do that. Payroll tax increases have become a significant factor in the inflation spiral, adding to the cost of goods and services and driving up prices. We think it would be wholly inappropriate, in attempting to deal with social security's short-term fiancial problem, to stack up more payroll taxes over and above what is already in place and scheduled for the future.

Ms. **Ferraro**. All right. If you are not advocating more payroll taxes; I am saying to you at the present time you could not get it out of general revenues. Would you want this program, the earnings test eliminated at the cost of other programs, or do you feel that it would not be at the cost of other programs?

Mr. **Hacking**. Over the long term the associations advocate a restructuring of social security in the context of the whole income-support structure. That would imply some kind of changes that could be characterized as deliberalization, changes in terms of eligibility for benefits, benefit computation, and the components of the benefit structure. However, we also adhere to a fundamental principle of entitlement programs, and that is that no deliberalizing change should be made in the short term because that would result in a changing of the rules of the game on people at the last minute, thus defeating their reasonable benefit expectations. So we cannot go that way, either. I guess I am not going to be able to solve your priority problem for you. We think general revenues simply must be introduced into social security to compensate the programs for the damage being done to them by economic conditions. We are suggesting that a little more be added to begin a scheduled phase out of the earnings test of a period of years.

Ms. **Ferraro**. You think things should remain status quo until we get general revenues to come in and provide for this additional benefit?

Mr. **Hacking**. It has to be done.

Mr. **Pellechio**. I would like to caution against thinking the decision was between the earnings test as it exists now and elimination of the earnings test. I think sometimes the cost calculations for eliminating the earnings test are a bit of a scare tactic to support the status quo.

My evidence shows that an increase in the exempt amount, but not elimination of the exempt amount, will be revenue-generating, at least for changes on the order of 50- to 100-percent increases in the exempt amount.

The thing that bothers me about the arguments for the status quo is that they have no calculations to justify this particular exempt amount and this particular tax rate. By either historical accident or linear income tax arguments we have an earnings test functioning the way it does today. If the status quo is revenue-maximizing, then we should see calculations of the following kind: We should be shown that for a $1,000 increase in the exempt amount, or a $1,000 decrease in the exempt amount, there would be a reduction in social security revenue. That would be a clear indication that the earnings test as it functions now maximizes social security revenue. This is one way of defining an efficiently operating earnings test. I do not see that in the argument for the status quo. I see statements of philosophy, glib assertions about no behavioral responses. That is just not true from the evidence. There are behavioral responses. I am saying let us take the earnings test as a structure and try to figure our where the revenue-maximizing point is. I bet that if we raise the exempt amount, we will be collecting more revenue and making people better off.

Ms. **Ferraro**. I think that is what Mr. Ossofsky was speaking to, a liberalization.

Mr. **Pellechio**. That is right.

Ms. **Ferraro**. Is it not that we are only looking at the status quo or total elimination, but perhaps being able to find something that falls in the middle that will not further bankrupt the system, not further hurt people who are in the system, as Miss Sommers testified? She is very, very worried about women under social security that they might be the people paying for the elimination of this earnings test. I think that we can possibly move towards liberalization. I see that as a future thing.

Mr. **Pellechio**. Not necessarily meaning elimination, but just some reasonable increase in the exempt amount to $12,000 or $15,000 a year, taking advantage of that split in the earnings distribution that those figures illustrate.

Ms. **Ferraro**. Thank you very much.

Mr. **Burton**. I would just like to make a comment. I know when they reached the compromise in the 1977 bill, they did not do a study. They did not have time to do a study. They were just fighting to hold on to something, because the House overwhelmingly voted for elimination. They had to compromise. All they were doing is picking something out of the air. They did not have a study on that.

Ms. **Oakar**. Mr. Chairman, I think that is the point, that Mr. Pellechio has brought forth a study, whereas the Social Security Administration made generalized statements about the fact, the theory that it would cost $1.2 billion. Everybody has repeated that. Nobody has told me how they arrived at that. You seem to indicate, I think you said that the loss—the system would lose money—the system loses money because of the loss of payroll taxes.

Mr. **Pellechio**. That is the point.

Ms. **Oakar**. You do not see necessarily you have to go to the general revenue for some liberalization.

Mr. **Pellechio**. That is right.

Ms. **Oakar**. The system would pay for itself?

Mr. **Pellechio**. That is right. It looks like a self-financing or revenue-generating change. It is possible that is the case even for something as extreme as elimination. But it is certainly the case for significant increases in the exempt amount. I think the stacking up of people at the exempt amount or just below, and also the fact that they move with the changes in the exempt amount, clearly indicates there is some payroll-tax mileage to be gained from raising the exempt amount significantly. People have showed us over this 10-year period, they have done it.

Ms. **Oakar**. Did you find in your study at all some people were cutting a deal with certain employers because they did not want to go over the amount? I mean, it is so obvious.

Mr. **Pellechio**. My data source—the full title is the Current Population Survey Internal Revenue Service Social Security Administration Exact Match Fund—is a collection of data from those three agencies on earnings and wealth and labor force participation of a current population survey sample. I do not have evidence of it.

Ms. **Oakar**. Have you made a study of the manner in which social security arrives at their conclusions?

Mr. **Pellechio**. Some of the early calculations were rather simple. It was just an arithmetic exercise, where the earnings test was hypothetically changed and the calculation was done with no behavioral responses to those changes. In other words, people did not move up with the exempt amount, if the exempt amount were raised. The calculations——

Ms. **Oakar**. So you have really challenged the manner in which they do their research?

Mr. **Pellechio**. Yes. I do not think there is any careful recognition of behavioral responses to the changes that they are talking about. And I am saying let us look at it historically and see if there are behavioral responses based on the way the system operated in the past. And the haphazard changes in the exempt amount give us a very clear picture of how people respond to changes in the exempt amount.

Ms. **Oakar**. The other thing is we have heard so much about—the report from last week—that the old age and survivors' benefits are in some trouble. But they did not say, or at least publicitywise, that there was a surplus in the disability area, so that why not view the trust fund as a whole. Again, it just caused a lot of anxiety. I do not think the whole picture was told, from their superficial study, based on a board that is appointed, et cetera, et cetera, three-person board, I think.

Could I ask you, you were appointed by the President?

Mr. **Woodruff**. No. By the Chairman of the Commission, Peter McColough, who was appointed by the President.

Ms. **Oakar**. I think it is kind of interesting that you have two avenues of administration that disagree.

Mr. **Woodruff**. We report both to the President and to Congress. So we have some independence.

Ms. **Oakar**. That it right. So the Social Security Administration really disagrees, and yet——

Mr. **Woodruff**. We feel another thing that is being overlooked in some of the current cost studies is the hidden cost of forcing people to be overly dependent on social security as their major source of income. We feel that another thing that should be looked at is the long-run cost of future demands on the social security system for significant benefit increases. People do not have other sources of income; if this continues, there are going to be very serious problems ahead. We think that changing attitudes toward work and providing incentives for continued work force participation are very effective ways of helping avoid these problems.

Ms. OAKAR. Do they work closely with you, just out of curiosity? I mean the Social Security Administration.

Mr. WOODRUFF. We ask social security and the other executive branch agencies frequently for cost and other factual studies. We do not ask them for policy studies, however. We currently have asked the Treasury Department to do a series of revenue losses and gain estimates on the whole series of our proposals; that should provide us at least some additional information on what the Social Security Administration testified on this morning. We are very interested also in Dr. Pellechio's study.

Ms. OAKAR. Doctor, have they commissioned you at all?

Mr. PELLECHIO. No.

Ms. OAKAR. Do they have the benefit of your study? Have they asked you for it?

Mr. PELLECHIO. I do it for free for them.

Ms. OAKAR. Have they sought your studies?

Mr. PELLECHIO. Oh, yes. Emily Andrews, who I believe works in your office, contacted me about reviewing some research they were supporting.

Ms. OAKAR. I mean the Social Security Administration.

Mr. PELLECHIO. Yes. They are interested in what I am doing. And perhaps some of this evidence may get us together to figure out what the optimal earnings test is, because I think I have made my point.

Ms. OAKAR. I think so, too.

Mr. PELLECHIO. Thank you.

Ms. OAKAR. Thank you.

Mr. BURTON. Thank you very much.

The subcommittee is adjourned.

[Whereupon, at 1:30 p.m., the subcommittee was adjourned, to reconvene at the call of the Chair.]

APPENDIX 1

Submitted for the record by Chairman Burton

STATEMENT OF LAWRENCE ROTH

My name is Lawrence Roth and I work for Legal Assistance to the Elderly, Inc. as a paralegal. I have been retired for the past seven years. Before retirement I was the production manager for a packaging company. I retired early because my wife was sick. During the years much of our savings was used up due to her illness. She died in 1976.

Late in 1974 I started as an unpaid volunteer at Legal Assistance to the Elderly, 944 Market Street, San Francisco. The State of California Dept. of Aging sent me to paralegal seminars on dealing with legal problems of the elderly. In June, 1977 I got on the VISTA program, Volunteers in Service to America and have been a VISTA until recently. My function as a paralegal working under the supervision of an attorney is to interview Seniors who had legal and/or social problems and help to sort out and route to the most effective solutions.

My last year's earnings were about $5,100. Social Security taxes were taken off the top, about $300. April 15th this was reported to the Social Security Office in Baltimore when I sent them a copy of the W2 form. Having earned $600 over the $4,500 earnings limit in 1979, Social Security will take 50¢ out of each $1.00 I earned over the limit, or $300.

That $300 would have paid my rent, utility and phone bill for one month, a sum I cannot afford to lose.

The surest way to keep the elderly off the job market and deeper into poverty is to tax them outrageously. I resent it.

Signed,

LAWRENCE ROTH.

SOCIAL SECURITY: A CASE FOR CHANGING THE EARNINGS TEST BUT NOT THE NORMAL RETIREMENT AGE

(By Peter Diamond)

ABSTRACT

Increasing the normal retirement age for Social Security has been proposed. Analysing the proposal reveals that the largest benefit cuts would fall on the earliest retirees, a group which is poorer than other retirees. At present the earnings test is applied to all of benefits for workers under 72 (soon to be 70) and to none of the benefits for old workers. It is proposed, instead, to apply the earnings test to a smoothly decreasing fraction of benefits. Thus older workers with high earnings would receive a growing fraction of benefits. This provides a better incentive to continued work than the current system.

Despite the large changes in the 1977 Amendments to the Social Security Act, current forecasts call for more tax increases. Since this call is not very popular, people are examining various ways to decrease the growth of benefits for future retirees. There has been considerable support for decreasing benefits by increasing the normal retirement age. After briefly reviewing other methods of slowing benefit growth, this proposal is analysed below. The proposal is found unsatisfactory since it concentrates benefit cuts on a relatively poor group, the early retirees. Whatever changes are made to save revenues, it would be good to increase the incentives for more work. An attractive method would be to pay an increasing fraction of benefits to workers as they age, independent of earnings. Equivalently this proposal can be seen as applying the earnings test to a decreasing fraction of benefits.

The 1977 amendments

In the annual reports of the Trustees and in the evaluation of legislated changes, the Social Security Administration's actuaries try to forecast cash flows for the following 75 years. Since the program will eventually affect even the youngest of today's payroll taxpayers and since it has tremendous financial inertia, advance planning is extremely important. To have the estimates in a meaningful form they are stated as a percentage of taxable payroll, averaged over 75 years. The estimates can then be compared with the payroll tax rate, which was 9.90 percent in 1977 if we exclude the Medicare. With no change in Social Security, it was forecast then that the deficit would be 8.20 percent of taxable payroll. That is, promised benefits were roughly twice the size of what could be financed with the then current tax rate.

There were many changes voted in the 1977 Amendments. Those that affected benefits saved 4.98 percent of taxable payroll. Those that raised taxes only added 1.78 percent of payroll. And the remaining forecasted deficit was 1.46 percent—about the same size as the tax increase. It is true that the deficit does not appear in the forecasted annual budget until the baby boom generation, now in their thirties, starts retiring. When that happens we will witness a 50 percent increase in the ratio of the aged to the working age population. Without a large Social Security Trust Fund, this increase is bound to generate pressures. Little has changed since 1977 to alter this general picture of the long term problems, while the short term problems are more severe than was forecast.

Slowing benefit growth

Of course, the public response to the 1977 Amendments was not to this picture of a financially straitened distant future. Rather the public noticed the small tax increase of 1978 (which was in place before the 1977 Amendments) and the planned 14 percent increase in payroll taxes over the next decade. Even more they noticed that a large share of this increase came from raising the maximum earnings subject to tax. Measured by bills introduced, the initial response of Congress was to substitute an income tax increase for the payroll tax increase. This would change the distribution of the tax increase, and might be less visible to angry voters; but would not address the basic question of whether benefits are growing more rapidly than we are willing to pay for.

The 1977 changes provide benefits per new retiree which grow roughly in proportion with wages per worker. However, with the number of retirees per worker growing rapidly, total benefits are scheduled to grow substantially relative to the economy. Increasing tax consciousness in one reason to slow this rate of benefit increase. A second reason is that real wages are expected to grow over the long run. Future retirees will have had considerably higher incomes than current retirees. It is reasonable to expect them to finance a higher percentage of their retirements themselves. Since part of the payroll tax increase is to accumulate revenue for future benefits, rethinking future benefits permits reconsideration of the payroll tax level we need now.

Methods of cutting planned benefits

There appears to be a wide consensus that present, and future, retirees should continue getting benefit increases to offset increases in the cost of living. Thus if we want to cut total benefits we must decrease benefits for new retirees or decrease that rate of retirement.[1] I expect we will do both. But there is no reason to think that a single change would be a good way to distribute benefit cuts across the population and simultaneously encourage people to work longer and retire later. So, we need to think about cutting benefits. And to think about encouraging more work. And then put the two pieces together.

There are lots of ways of cutting benefits. The most straightforward is to decrease the benefit table used of determining benefits of new retirees. Under current law the calculation to determine benefits is different for people born in different years. The differences are determined by the growth in average wages in the economy. It would be straightforward to add a second difference to slow the rate of growth of benefits determined by these tables. In this way the legislation to decrease benefits would have direct control over the way the benefit cuts are distributed over retirees of different ages and with different levels of benefits.

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[1] Also, we could decrease disability, survivor, or dependent benefits.

Another straightforward method would be to include part (or all) of Social Security benefits in taxable income for the U.S. income tax. This extra tax revenue could be channeled to the Social Security Trust Funds. The virtue of this method is that benefit cuts would be greatest for those in the highest tax brackets, who are best able to absorb a benefit decrease. While this idea has been enormously popular with economists, it has been a repeated non-starter in Congressional discussions.

There are also complicated (and less visible) ways of cutting benefits. With the new Amendments, a wage index is used both to calculate an individual's average indexed earnings and to change the benefit table which relates benefits to past indexed earnings. We could substitute a price index for the wage index in these two steps in the calculation of benefits. Provided that wages grow more rapidly than prices this change would noticeably slow benefit growth. As successive generations of workers have higher real earnings they would move up the benefit table into regions where benefits are smaller fractions of earnings. Wage indexing removes this consequence of higher earnings by shifting the benefit table in step with average wage growth. With price indexing, real benefits depend on an individual's history of real earnings. With wage indexing, those born later receive higher benefits than their elders who had the same real earnings. Compounded over a long time this difference is substantial. Price-indexing received some attention before the 1977 Amendmens were voted, although it was a late starter in political discussions.

A proposal which has received considerable attention and wide support is to delay the normal retirement age for receipt of benefits. The first three methods of cutting benefits seem to me to be good ideas, separately or in combination. Delaying the normal retirement age is a poor way to cut benefits and a poor way to encourage later retirement and fewer beneficiaries. Since it has received so many endorsements (and so little analysis) we need to look closely at its workings.

Delaying the normal retirement age

Although anyone over 62 can stop working and claim retirement benefits, the "normal" retirement age is 65. By this we mean that those retiring before 65 have their benefits decreased for "early" retirement. Those who first claim benefits after 65 have benefits increased for "late" retirement. In other words, benefits are larger the older the retiree when benefits are first claimed. In addition to the semantic difference between reductions for early retirement and increases for late retirement, there is a substantive difference. The reductions are larger than the increases. Retiring at 62 reduces benefits by 20 percent compared to retirement at 65. Working to 68 rather than 65 only increases benefits by 9 percent (under the 1977 Amendments). This pattern is shown in Figure 1, which shows the pattern after legislated changes go into effect for 1982. (This discussion of actuarial reduction and the delayed retirement increment ignores the fact that a year of good earnings will raise a worker's AIME, and so the worker's benefits.)

The proposal to change the normal retirement age to 68 is a proposal to shift this schedule of reductions and increases. Someone retiring at 65 would receive a 20 percent reduction for early retirement rather than the benefit appropriate for retirement at the normal age. Someone retiring at 68 would be retiring at the normal age and would not receive the present 9 percent increase for working past the normal age. In this way the proposal to delay the normal retirement age is a proposal to cut benefits. The change is shown in Figure 2.

This approach to cutting benefits does not relate the size of the percentage cut to the size of the benefit, making it important to examine its implications for the distribution of income. Concentrating benefits cuts on early retirees is unattractive since they tend to have longer retirements to finance and to have had shorter periods to accumulate funds for retirement. A further, and more serious, issue arises when we look more closely at the makeup of 62–64 year old retirees. For these contain a very needy group. At present, well over half of new retirees, both male and female, are under 65. Sixty per cent of the early retirees claim benefits at 62. In a detailed survey in 1968 (when the unemployment rate was only 3.6 percent), it was found that 40 percent of 62 year old male retirees had been out of work at least six months before becoming eligible for benefits. One in six of the male retirees had been out of work for three years or more before receiving benefits. With this level of hardship one must take care in applying the changes that go with a delay in normal retirement. To simply shift eligibility for retirement benefits by three years, from 62 to 65, would be intolerable. To simply extend the rate of benefit reduction for early retirement for six years rather than three would give a 62 year old retiree a 25 percent cut in benefits (80 percent of the benefit at 65 will drop to 60 percent of the same benefit at 68). With so many of these people receiving low benefits, such a large change would be unduly harsh. There is one proposal to exempt many of these early retirees from any benefit cut. This would be done by introducing a new, weakened, definition of disability for those between 62 and 65.

Those satisfying the new definition, but not the present one, would be given the same benefits as at present without disability. Only those who don't satisfy even the weaker definition would have their benefits cut 25 percent because of the delay in the normal retirement age. It is not known how many of the hardship cases would be reached in this way. No doubt some of them would be missed.

Incentives for longer working lives

Delaying the normal retirement age is not only inequitable; it also preserved the inefficient incentives to work of the present system. There are better systems of incentives to encourage later retirement. For a worker between 62 and 70 (when Social Security benefits will be paid independent of retirement after 1982) there are two sides to the financial return to further work. One is the immediate financial gain—the excess of take-home pay (plus fringes) over the pension available with retirement. The other side is the increase in future retirement benefits as a result of an extra year's work. The value to a worker of a larger future pension depends on many factors—the size of the pension increase, the date when pension benefits will start, life expectancy of the worker, the presence of any dependents who will also receive larger benefits, and the worker's need for current income relative to future income. Obviously relative to current earnings. They may also differ in the accuracy of their understanding of the future payoff to current work.

By only delaying the normal retirement age, we would preserve two unsatisfactory aspects of the current incentives for longer work. One is that we rely too heavily on future benefit increases and not enough on current income to encourage work. We can arrange a more efficient incentive by paying part of the retirement benefit independent of retirement and still preserve the insurance aspect of Social Security. The second unsatisfactory aspect is the pattern of benefit increases with longer work. As workers age, the length of time they expect to collect higher delayed benefits gets shorter. To preserve the level of work incentive the rate at which future benefits grow with delayed claiming of benefits must increase as workers age. But the current system has the reverse pattern—much more rapid benefit growth with additional work at younger ages than at older ones.[2]

A proposal to encourage more work

To correct these two problems, let us pay a growing fraction of retirement benefits to those between 65 and 70 who continue working. For example 15 percent of benefits could be paid to 65 year olds who continue working. The remaining 85 percent would be subject to the same retirement test as at present.[3] Those who are 66 would receive 30 percent of benefits independent of retirement, with 70 percent still subject to the retirement test. The fraction paid independent of earnings would grow until age 70 when, as under the new Amendments, full benefits would be paid.[4] While these numbers aren't sacrosanct, the principle of paying a growing fraction of benefits independent of retirement would significantly enhance work incentives.

The proposal involves only partial benefits for those between 65 and 70. There have been frequent suggestions to pay full benefits to everyone over 65. This would be going too far, losing significant aspects of the Social Security system. Individuals don't know when they may be forced to retire. If this happens early, they are worse off than if it happens late. By paying only partial benefits if an individual has high earnings, we can finance larger benefits if he has to retire early. This provides important insurance to an individual. A second aspect of the same principle is that, on average, those who continue earning are financially much better off than retirees. By paying lower benefits to late retirees and higher benefits to early ones we give more money to those with greater need. The problem in designing the Social Security system is to strike the right balance between work incentives and the provision of insurance. We need to combine slower aggregate benefit growth, greater incentives for work, and continued provision of greater benefits to those with greater need to have a Social Security system which works more efficiently and costs less.

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[2] For a theoretical model supporting these two propositions, see two papers I have written with James Mirrlees.

[3] That is, benefits would be reduced by $0.50 for each $1 of earnings beyond the exempt amount as at present, but benefits would not be reduced below 15 percent of their full amount. Alternatively, the benefit amount independent of retirement could be added to reduced benefits (up to 100 percent of benefits) in the event of work above the exempt amount.

[4] The Office of the Actuary has estimated that this proposal would cost 0.06 percent of taxable payroll. This estimate is based on the assumption that the proposal has no effect at all on retirement ages. The cost would be less if some workers respond by working longer.

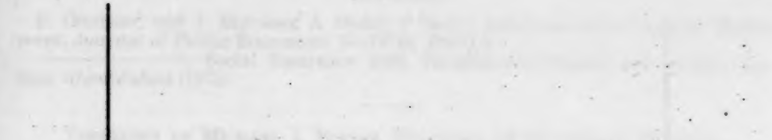

Figure 1. Benefits at different retirement ages, AIME held constant

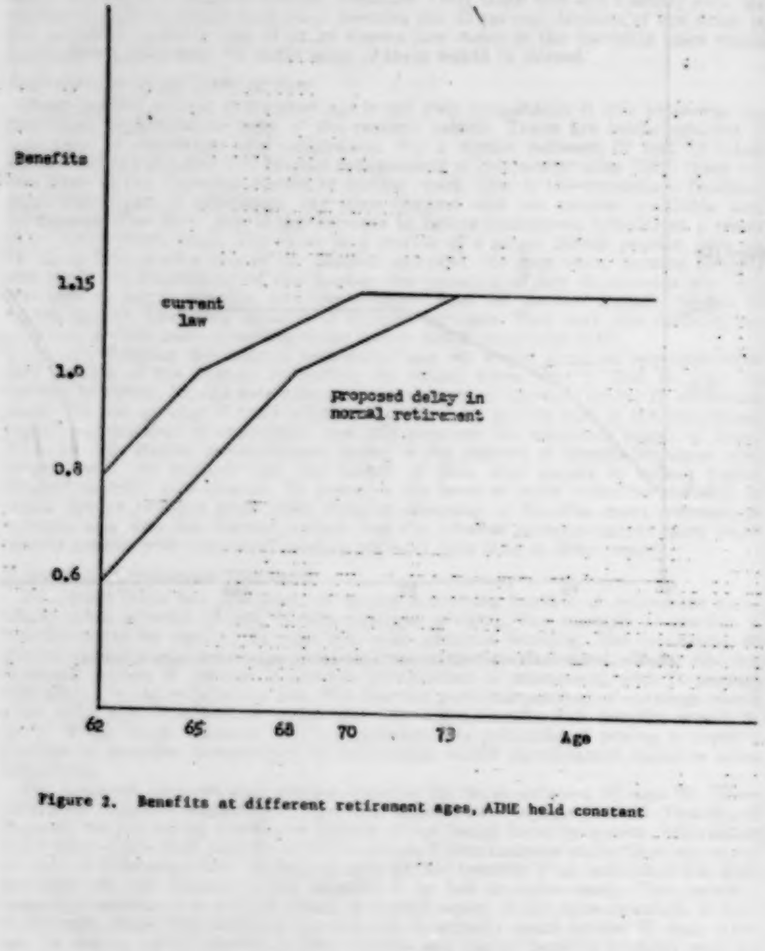

Figure 2. Benefits at different retirement ages, AIME held constant

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Testimony of Michael J. Boskin, Professor of Economics, Stanford University

THE ROLE OF THE EARNINGS TEST IN SOCIAL SECURITY

I believe the earnings test in the Social Security System should eventually be eliminated. However, I do not favor eliminating the earnings test currently nor do I favor eliminating the earnings test independently of other structural reforms in Social Security. I believe the earnings test has been part of the explanation of the substantial decline in the labor force participation of the elderly and that removing it would, on balance, increase incentives to work and create a situation in which the elderly, on average, would work longer before retirement. But I believe that the earnings test is at the core of a confusion in Social Security between its twin goals of providing adequate income support—the transfer or welfare goal—and of providing social insurance or forced saving for retirement—the earned entitlements goal. I therefore believe that abolition of the earnings test should occur in the context of a reform of Social Security which would separate these two goals of the system and fund them separately; and would also gradually raise the age at which full Social Security benefits could be received. Let me amplify on each of these points below.

If it were the case that the current, or projected future, Social Security System would provide to each and every individual a common expected return on their cumulative lifetime contributions, an earnings test would have no place whatsoever in the System. Social Security would then be an earned entitlements program, and it would be inequitable to "tax" away some of the benefits earned by people paying in to the System. However, while this is one way to view Social Security, in fact the System today is a long way from this ideal. It combines this ideal with substantial elements of income redistribution both within and across generations. In particular, virtually all elderly persons currently receiving Social Security benefits are receiving back a large multiple of what they and their employers paid in plus any reasonable rate of return; and eventually very young workers are very unlikely to receive back their principal, let alone interest thereon. Among the features that create this income redistribution are the tilt in the benefits formula, the capricious way average monthy earnings are computed do not span an individual's entire lifetime of contributions, the fact that the benefits are financed on a pay-as-you-go basis whereby the current benefits are financed by the current taxes, not by the taxes previously paid by the individuals currently receiving the benefits, etc. Since the System attempts to provide income adequacy during retirement, and this goal is widely shared policy, the Supplemental Security Income System provides an additional anti-poverty program for the elderly. However, this System is placed on top of a system which already provides substantial income transfers to the elderly population. My own belief is that an earnings test belongs only in the income adequacy or transfer or welfare part of the System, and not at all in the earned entitlements part of the System. So long as one attempts to achieve the twin goals without two interrelated systems, an earnings test will be deemed fair to some, and a cost expedient necessity to others.

Further, the earnings test contributes to the explosion in early retirement noted above. Shortly after World War II, about one-half of elderly men were in the work force; today that number is only one in five. Substantial declines have also occurred in the labor force participation rate of men in their late fifties and early sixties. There are undoubtedly numerous resons for these reductions in labor force participation rates. While the exact partition of the responsibility of this decline is difficult to establish, there is by now substantial empirical evidence that Social Security has indeed contributed to the explosion in early retirement. In particular, it is my belief, that on balance, the earnings test, has led to an increased fraction of the elderly population retiring earlier than they otherwise would have done. More people now collect their first Social Security check at age 62 than at age 65. At the same time that retirement at an earlier age is becoming a widespread phenomenon, the life expectancy of the elderly has been increasing dramatically since 1960. This increase in life expectancy has been about three years for women and a year and a half for men. Combined with earlier retirement, we have seen a lengthening of the typical retirement period of approximately thirty to thirty-five percent. This obviously places greater stress not only on Social Security, but on private saving and intrafamily intergenerational support patterns in order to provide any given level of income annually for a much longer period of time during retirement.

But much has changed since we adopted such retirement ages. The labor force has gradually shifted out of physically demanding and dangerous jobs; the increased life expectancy and improved health of the elderly have been well documented; workers are entering the labor force later; and the long term financial integrity of Social Security is in doubt. For all of these reasons, and others, I strongly favor a gradual phasing in of an increased retirement age at which people could collect full Social Security benefits from the current 65 years of age to 67 or 68 years of age. I would do so gradually over the next three decades. Such a proposal, would put the long term financial status of Social Security on much firmer ground and actually provide a very modest surplus under the base case assumptions of the trustees of the Social Security Administration.

In the context of separating the transfer and earned entitlements goals of Social Security and gradually increasing the retirement age, whatever short term cost implications elimination of the earnings test might imply,[1] would be substantially ovecome. Further, with the rationalized twin system described above, there would be no need for an earnings test in the earned entitlements part of the System and all claims for increased benefits because of needy circumstances would occur in the income adequacy part of the System which would be means tested as usual under income maintenance programs.

In brief summary, I favor abolishing the earnings test in the regular Social Security System, but only in conjunction with other structural reforms in Social Security which will both rationalize the benefits structure and provide the financial stability in the long run that Social Security so badly needs.

AFL-CIO FACT SHEET ON RETIREMENT TEST

The retirement test is one of the most controversial and least understood provisions of the Social Security Act. This test provides that Social Security benefits are payable in full if a person's annual earnings remain below an exempt amount—$5,000 for those over 65 and $3,720 for those under 65. These amounts are automatically increased periodically in accordance with increases in covered wages. If earnings exceed these levels, the Social Security benefit is reduced $1 for each $2 of earnings in excess of the exempt amount.

The AFL-CIO opposes abolishing or liberalizing the retirement test. The Social Security program is an insurance program that insures against the loss of income from work and that pays benefits when that loss occurs. In other words, the purpose is to provide insurance against the loss of earnings due to retirement, disability or death of the worker. Like other forms of insurance, the program insures against specified risks and it does not pay benefits unless the risk against which it insures actually occurs.

It is true that the retirement test applies only to earned income. By paying benefits regardless of other financial resources, Social Security serves as a base on which other forms of protection such as investments, savings, insurance and private pensions, etc. can be built. Withholding benefits because of sources other than nonwork income would reduce incentive for savings and would make it impossible for most people to make provisions for a more financially secure old age than would be possible by Social Security benefits alone. It would also jeopardize the eligibility of private pension recipients to receive Social Security benefits. It might also increase the danger of the introduction of a means test for Social Security recipients.

The AFL-CIO has always supported changes in the Social Security law that were aimed at meeting major social purposes rather than the convenience of a minority. Repeal of the retirement test would increase the cost of the Social Security program by billions of dollars a year now and more in future years. But only a very small percentage of total retirees have any benefits withheld under the retirement test. Its elimination would benefit inordinately that small group of people who would be eligible for benefits even though they were working full time.

The large majority of aged persons are unable to work because of poor health or lack of employment opportunities. Obviously, this is a group for which full-time work cannot be expected to be a satisfactory means of supplementing Social Security benefits. More adequate cash benefits are what is needed.

The AFL-CIO realizes that the retirement test earnings exemption must be adjusted from time to time in accordance with increases in wages and prices. This is

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[1] These cost estimates are probably overstated somewhat due to the failure to allow for the likely later average retirement.

the reason the AFL-CIO supported adoption of the provision in present law that increases the exempt amount periodically in accordance with increases in covered wages. Further liberalization is not needed. Instead priority should be given either to increasing benefits for all beneficiaries or to preventing an increase in the Social Security tax for low and middle income workers.

APPENDIX 2

Submitted for the record by Representative William C. Wampler

DARTMOUTH COLLEGE,
Hanover, N.H., June 16, 1980.

SELECT COMMITTEE ON AGING,
H.O.B. Annex No. 1, Room 714,
Washington, D.C.
(Attention) Ms. Mary Garver.

GENTLEMEN: I am very pleased to have been asked to prepare this statement on the social security system's earnings limitation test. I have been studying the social security system for the last 18 years and have done considerable writing on the subject. I am an adjunct scholar at the American Enterprise Institute, Washington, D.C., and since 1974 have been directing their studies of social security.

In the 1977 amendments to the Social Security Act, Congress took several steps to lessen the disincentives for older persons to work:

(1) The allowable earnings for persons over sixty-five were raised.

(2) The age at which all persons may receive full benefits without regard to earnings will drop in 1982 from seventy-two to seventy.

(3) The percentage increase in the old-age benefit of a worker who has delayed retirement past age sixty-five was raised from 1 percent for each year to 3 percent.

While these steps were in the right direction, I believe it is important that Congress go further than this and eliminate the earnings limitation test completely.

Although payroll tax rates were raised in the 1977 amendments, they were admittedly not raised sufficiently to cover the projected costs of the system over the next seventy-five years. The reasons for the exploding cost of the system are the sharp decline in both the birth rate and the death rate. These demographic changes are eventually going to raise the ratio of the number of beneficiaries per worker, and—if no changes are made in the present social security system—would necessitate a sharp rise in payroll tax rates.

Reversing the present trend toward earlier retirement—in part by eliminating the earnings test—is an important way in which the expected rise in payroll tax rates may be avoided. During the past thirty-five years, there has been a sharp trend toward earlier retirement among men. As mentioned in the enclosed study that my wife and I wrote entitled "Conflicting Views on the Effect of Old-Age and Survivors Insurance on Retirement," published in "Economic Inquiry" in September 1976, in 1947 one out of every two men aged 65 and over were in the labor force; today only one in five is working. This downward trend in labor force participation among older men has been carefully studied in recent years, and there is little doubt that it is partly the result of the earnings test. Although the law recently passed by Congress eliminating mandatory retirement at age 65 will help to reverse the trend toward earlier retirement, the earnings test is still a major obstacle to achieving this goal.

The historical objective of the earnings test was to induce persons to retire so as to release jobs for unemployed younger persons. This objective was plausible during the 1930s when rates of unemployment were very high. However, it is not an appropriate objective today. In view of the major demographic changes that have occurred and in view of the long-run financial problems of the social security system, government policies should be changed so as to encourage older persons to work.

Public policies—such as the earnings test—that attempt to create jobs for young persons by inducing others to leave the labor force are based on the misconception that the number of jobs in the economy is fixed. Instead, the number of jobs varies with wage rates. If wage rates rise less rapidly, for example, the number of jobs will be larger, and if the supply of labor exceeds the demand, this will dampen the normal rise in wage rates.

Supporters of the earnings limitation test usually argue that removing the test would be costly and would require an immediate increase in payroll tax rates. However, the number of persons age 65 and over who forfeit part or all of their social security benefits because they are working is only about one million persons. The important effect of the elimination of the earnings test would be to induce a significant number of older persons, who are already receiving social security and are not now working, to take jobs—resulting in increased payroll tax revenues. This would pay for a large portion of the short-run increase in costs resulting from the elimination of the earnings test.

An argument that is frequently given for retaining the earnings test is that removing it would not help those older persons in greatest need. This argument is made by those who view the OASDHI program as a welfare rather than an insurance system. But, the OASDHI program is viewed by most people as an insurance program. The continued popularity of the program and the public's willingness to pay higher payroll taxes are probably dependent on whether the system conforms to insurance principles. One of the most unpopular aspects of social security is that many persons believe they ought not to be asked to forfeit benefits they have paid for.

Sincerely,

COLIN D. CAMPBELL.

Enclosure.

CONFLICTING VIEWS ON THE EFFECT OF OLD-AGE AND SURVIVORS INSURANCE ON RETIREMENT

COLIN D. CAMPBELL
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ROSEMARY G. CAMPBELL
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The literature explaining the sharp drop in labor force participation of the elderly in recent decades is examined. Several recent studies made by economists outside the Social Security Administration have found the impact of OASI to be much more important than was found by surveys made within the social security system. An examination of census and manpower data lends support to the view that OASI has had an important role in encouraging retirement at earlier ages. The drop in labor force participation among the elderly has impeded government efforts to improve the economic condition of elderly persons.

Labor force participation of men 65 years of age and over dropped from 48 percent to 22 percent between 1947 and 1974 — a period of only 27 years. Researchers within the Social Security Administration (SSA) have usually concluded that this was not the result of the growth of the social security system even though during this period persons with Federal old-age and survivors insurance (OASI) — not including their dependents — rose from 15 percent to 67 percent of the total number of persons 65 and over. Studies made within SSA have concluded that almost all persons retire involuntarily because of bad health, difficulties finding a job, or reaching compulsory retirement age. In contrast with these results, studies of labor force participation by economists outside the social security system have usually concluded that OASI has had an important effect on the accelerated rate of retirement. This paper is a review of these conflicting points of view.

If OASI has a negative effect on labor force participation, this is significant. It could cause OASI to fail to achieve its humanitarian objective of shifting income from the young to the elderly. If older persons have been induced by OASI to work less, the increased transfer payments received by them could be offset by a reduction in their earnings. Although the value of increased leisure to elderly persons may offset the loss of earnings, as a tax-transfer program OASI is usually viewed as a program to raise the money income of elderly persons. Between 1947 and 1974 the median income of families with the head aged 65 and over increased only 4.0 times compared to between 4.3 and 4.9 times for other age groups except those under 24 years of age.[1] This overall decline in the relative income position of older families occurred despite the increase in federal old-age benefits and old-age assistance from $1.5 billion in 1947 to over $47 billion in 1973.

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[1] See U.S. Bureau of the Census, Series P-60 (1949, p. 18; 1976, pp. 43-45).

ECONOMIC INQUIRY, Vol. XIV, No. 3, Sept. 1976.

I. OASI AND LABOR FORCE PARTICIPATION

There are two ways in which OASI may induce older persons to retire. Unless persons eligible for old-age benefits give up full-time employment, they are not entitled to an old-age pension because their earnings would exceed the amount allowed by the work-income test (also called the retirement or earnings test). In addition, OASI may encourage retirement by providing older persons with funds to pay for at least part of their living expenses without working.

The Work-income Test. For any earnings over a given amount (in 1976, $230 a month or $2,760 a year), a person's pension is reduced $1 for every additional $2 earned, up until the pension is completely exhausted.[2] This strongly discourages full-time labor force participation of most older persons because it is equivalent to a marginal tax rate of 50 percent, and more than this if payroll and income taxes are taken into account. Retired persons are entitled to their full pensions in months in which earnings are below $230, regardless of the amount of their annual earnings. As a result, the work-income test can be largely circumvented by the relatively small number of persons who can earn substantial amounts in one or two months of the year and less than $230 in the remaining months.[3]

In 1937 the original purpose of the work-income test was to reduce unemployment by releasing jobs for unemployed younger persons (Burns, 1936, p. 20, and Douglas, 1936, p. 171). Retention of this policy has been based partly on the belief that U.S. labor markets are still in disequilibrium — with the supply of labor exceeding the demand.[4] Policy makers have viewed compulsory retirement as a method of absorbing this excess supply. Other reasons that have been given for retaining the work-income test are the desire to avoid the increased cost of benefits that would result if this test were discarded and the belief that benefits are not needed by those who are fully employed.

Eligibility for Benefits. OASI may also reduce labor force participation by providing older persons with an alternative source of income. The social security system would have this effect even if retirement were not compulsory. Some studies have indicated that workers retire early if they can count on a dollar amount of retirement income that they consider sufficient to cover their basic needs, but not if their pension is below that desired level. Others believe that the significant factor in inducing persons to retire is the proportion of earnings given up. This is usually measured by the size of a person's replacement ratio (the amount of his social security pension relative to his pre-retirement earnings).

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[2] The limitation for self-employed persons is based on hours worked — no more than 45 hours per month are allowed, and in some cases as few as 15, depending on the type of work.

[3] To avoid this loophole, the 1974 Advisory Council on Social Security recommended that the work-income test be based solely on annual earnings except for the first year of entitlement to benefits. See U.S. Advisory Council on Social Security (1975, pp. xv, and 23-24).

[4] See Kreps (1968, pp. 33-34).

The current replacement ratios of persons with different levels of earnings, not taking taxes into consideration, are shown in Table 1. An elderly couple with the very low pre-retirement income of $3,200 has a replacement ratio of 92 percent because the benefit formula is favorably weighted for persons with lower earnings. A worker with a pre-retirement income equal to maximum covered earnings in 1974 ($13,200) who has an aged wife would have a replacement ratio of 44 percent. For aged couples with earnings equal to $26,400, the replacement ratio would be only 22 percent because of the upper limit to covered earnings and thus to the amount of benefits paid.

TABLE 1

Examples of Replacement Ratios
(Retirement at age 65 in 1975)

	Single Person, Age 65		Married Couple, Both Age 65	
1974 Pre-tax Earnings	Annual Old-age Benefit	Replacement Ratio	Annual Old-age Benefit	Replacement Ratio
$ 3,200	$1,955	61%	$2,934	92%
7,681	3,272	43	4,908	64
13,200	3,881	29	5,821	44

Source: U.S. Advisory Council on Social Security (1975, p. 104), and Rettig and Nichols (1974, Tables 4-6).

Persons with very low earnings can actually increase their total income when they become eligible for benefits if they work part time. Consider the example in Table 1 of a married couple whose earnings were close to the minimum wage in early 1974: their pension of $2,934 combined with the maximum earnings allowed by the work-income test ($2,520 in 1975) would amount to $5,454. This would be much larger than the couple's pre-retirement income of $3,200. In addition, the wage earner of the family would have been able to cut down on his employment, and the calculation does not take into consideration the tax advantages that benefits have over earnings. For persons with pre-retirement incomes above $3,200, the advantages of taking social security benefits and working part time are smaller, but may still be significant.

The replacement ratios in Table 1 are understated by the effect of taxes, especially at middle and maximum wage levels. Benefits are not subject to either payroll tax levies — currently 5.85 percent — or federal, state and municipal income taxes. Although a single person aged 65 must have an adjusted gross income above $2,800 a year and an elderly married couple must receive $4,300 in order to pay federal income taxes, for those with incomes above this level the minimum federal tax rate is 14 percent. To compute more accurate replacement ratios, untaxed benefits should be compared with after-tax pre-retirement earnings.

The low OASI replacement ratios of persons with high earnings, shown in Table 1, may also be misleading because many workers with high earnings records are entitled to other types of pensions. In 1972 almost half of wage and salary workers were covered by a private pension or a deferred profit-sharing plan.[5] Although there is wide variation in the replacement ratios of private or other public pensions exclusive of OASI, a recent study found the average private pension benefit replaced approximately 20 percent of previous earnings (Kolodrubetz and Skolnik, 1972, p. 80). In determining social security goals, Congress has assumed that most persons would supplement social security with private pensions or other types of saving.

The adequacy of replacement ratios is also affected by lower living expenses for the retired. A study by the U.S. Bureau of Labor Statistics (1968, Table 1, p. 4) estimated that retirement typically lowers living costs almost 14 percent of the amount of pre-retirement take-home pay (income after deducting payroll and income taxes). Living expenses may fall even more than the above estimate if a person moves from an urban to a rural community or to a part of the country with a warm climate.

II. STUDIES OF RETIREMENT BY THE SOCIAL SECURITY ADMINISTRATION

Over the past 37 years, the SSA has periodically investigated the reasons why beneficiaries retire. The principal method used in these studies is to interview retired persons. In a 1941-42 survey, their earliest study, only about 5 percent said they filed for benefits because they wished to do so and while they were in good health. The report concluded: "The fact that only 3-6 percent of the beneficiaries retired voluntarily in order to enjoy leisure is significant in evaluating the part old-age insurance benefits have played in influencing aged workers to leave the labor mar[illegible]t" (Wentworth, 1945, p. 18). In a report on surveys made in 1940-47, again only about 5 percent said they quit their jobs because they wished to retire. The report concluded that "most old people work as long as they can and retire only because they are forced to do so" (Stecker, 1951, p. 15). In a 1951 survey, only 3.8 percent retired voluntarily and in good health. The report concluded that "Most retired workers who are beneficiaries under the old-age and survivors insurance program do not leave their jobs because they want to; if their health permits and there is a market for their services, they would rather continue in gainful employment" (Stecker, 1955, p. 3). In the 1963 Survey of the Aged, 19 percent of the men who retired at age 65 and 11 percent of those retiring between ages 62 and 64 gave, as their reason, a preference for leisure. This is a sharp increase from the 1951 national survey. The 1963 survey concluded that "Although most men retire involuntarily — because of poor health, for example, or because they have reached compulsory retirement age — voluntary retirements are increasing" (Palmore, 1964, p. 3). In a 1968 survey of men who stopped working altogether, although only 2 percent of the newly entitled beneficiaries age 62-65 gave social security or other pension programs as their principal reason for retirement, 17 percent said they wanted to retire. This report concluded that "Seven in 10 men with reduced benefits gave one or more of the following reasons: they were physically unable to continue, their jobs were eliminated, their own businesses were doing poorly or they reached compulsory retirement age" (Reno, 1971, p. 14). Similar reasons were given by approximately the same percentage of beneficiaries retiring at age 65, although at this age fewer gave poor health as the reason for retirement and more gave compulsory retirement.

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[5] See Kolodrubetz and Landay (1973, p. 20).

A reason why these studies may have underestimated the influence of social security on retirement is the use of the interview technique. One would expect persons to give socially acceptable reasons for retirement and not to tell interviewers that they wanted to qualify for benefits or stop working. Self-interest is not considered a praiseworthy motive for personal conduct. In addition, a person's perception of his health or his ability to do heavy work is probably affected by the availability of alternative sources of income. Making OASI available to an individual may make him more likely to believe his health won't permit him to continue working. In their study of the economics of aging, Brennan, Taft, and Schupack (1967, pp. 20-23, 29-36) criticize the use of the interview technique, but still accept the SSA conclusion that OASI has had little effect on labor force participation. They conclude that an important reason for this absence of an effect was the low level of old-age benefits that they believe existed.

III. STATISTICAL DATA

Examination of the statistical series on labor force participation among the elderly, even without any attempt at correlation analysis, strongly suggests that OASI has induced older persons to retire.

The Drop in Labor Force Participation at Age 65. As is shown in Table 2, data on labor force participation *by age* from the last four censuses (1940 to 1970) show a striking drop in the participation rate at age 65 — the age when persons become eligible for full social security benefits. Also, after the 1950s, when the number of workers covered was increased 73 percent by including farm and domestic workers, most self-employed, and members of the armed forces, the drop in labor force participation at age 65 became much larger. For men the decline was 10 percent in 1940 and 1950 and approximately 25 percent in 1960 and 1970; for women it was 3.2 percent in 1940, 9.4 percent in 1950, 16.5 percent in 1960, and 25 percent in 1970.

Table 2 shows that labor force participation rates start to get smaller for each advancing year at approximately age 55. Deterioration of health could account for this gradual decline in the participation rate with age, but not for the very sharp drop at age 65. Part of the sharp drop in labor force participation at age 65 is caused by compuslory retirement at that age (Reno, 1972, pp. 7-8; Slavick, 1966, pp. 18-19). Although a person who is required by his employer to retire at age 65 may work for another employer or be self-employed, a shift of this type increases job-finding difficulties and often means lower wages and a less appealing job.

The Long-run Decline in Labor Force Participation. Data on the historical trend of labor force participation of older persons also indicate that OASI has induced older persons to retire. Table 3 shows that labor force participation of men 65 years of age and over dropped from 46 percent in 1950 to 22 percent in 1974. Table 4 shows that during this period, persons insured by OASI (not including their dependents) rose from 18 percent to 67 percent of the total number of persons 65 and over. The decline in labor force participation of older men has been much more rapid since 1950 than in decades prior to the establishment of the social security system — except for the 1930s. The decline of the labor force participation rate of men 65 and over was less than 8 percent from 1890 to 1900, 12 percent over the 20-year period from 1900 to 1920, and 3 percent from 1920 to 1930, compared to 28 percent from 1950 to 1960 and 19 percent from 1960 to 1970. The relatively large decline of 22 percent from 1930 to 1940 was probably caused by the extraordinary conditions resulting from the Great Depression and the welfare programs of the federal government that were introduced at that time. The decline during the 1930s was partly reversed during the 1940s when older men took advantage of the improved job opportunities during World War II. The labor force participation rate for older men was approximately the same in 1950 as in 1940.

The gradual decline in labor force participation prior to the existence of the social security system was probably caused primarily by rising

TABLE 2

Age and Labor Force Participation
of Older Persons, 1940 to 1970

Male	Labor Force Participation Rate				Female	Labor Force Participation Rate			
Age	1940	1950	1960	1970	Age	1940	1950	1960	1970
55	89.5%	87.8%	89.9%	88.9%	55	19.9%	27.9%	42.5%	49.6%
56	89.1	87.8	89.0	88.3	56	19.2	26.7	40.7	48.7
57	87.8	86.7	87.8	86.7	57	18.0	25.4	39.7	48.0
58	86.9	86.1	86.7	85.8	58	17.7	24.8	38.6	46.5
59	85.6	85.1	85.1	83.7	59	17.4	24.1	37.0	45.1
60	81,9	82.1	83.2	81.3	60	16.8	23.1	34.7	42.9
61	81.4	81.4	80.7	79.2	61	15.3	21.0	32.1	40.2
62	79.7	80.0	78.6	72.7	62	14.9	20.9	29.3	35.9
63	76.9	77.6	75.7	67.5	63	13.8	19.1	26.1	32.6
64	74.4	75.2	70.0	63.1	64	12.4	18.0	24.3	29.3
65	66.9	67.7	53.6	47.1	65	12.0	16.3	20.3	22.0
66	62.0	62.9	45.9	41.9	66	9.6	13.4	17.6	18.8
67	57.8	58.2	41.9	38.6	67	8.9	12.2	16.2	17.0
68	54.9	54.2	39.5	35.4	68	8.2	11.4	14.6	14.7
69	51.4	51.2	36.6	31.5	69	7.5	10.1	13.2	12.9
70	44.0	44.5	33.2	26.9	70	6.3	8.1	11.7	11.1
71	40.8	42.0	29.0	24.6	71	5.4	6.7	10.2	9.8
72	37.4	39.0	27.8	22.1	72	5.2	6.0	9.0	9.1
73	34.5	34.0	26.9	19.8	73	4.0	5.4	8.8	7.8
74	31.4	30.8	25.1	17.4	74	3.9	5.0	7.6	7.1
75 and over	18.2	18.7	15.6	12.1	75 and over	2.3	2.6	4.3	4.7

Source: U.S. Bureau of the Census, *Census of Population, 1970* PC(2) — 6A, (1973, pp. 31-32).

TABLE 3

Labor Force Participation Rates, Persons 65 and Over, Selected Years, 1890-1974

Year	Males	Females
(Census Estimates)		
1890	68.3%	7.6%
1900	63.1	8.3
1920	55.6	7.3
1930	54.0	7.3
1940	42.2	6.0
(Department of Labor Estimates)		
1950	45.8	9.7
1960	33.1	10.8
1970	26.8	9.7
1974	22.4	8.2

Source: U.S. Bureau of the Census (1960, p. 71); U.S. President, *Manpower Report* (1975, p. 205).

living standards. In a multivariate regression analysis of data from 19 countries in 1960, Pechman, Aaron, and Taussig (1968, pp. 296-304) found that, other things being equal, there was a smaller percentage of older persons working in countries with higher levels of per capita income.

In addition to the expansion in OASI coverage, there has been a sharp increase in the percentage of those eligible for benefits who have chosen to retire. Table 5 shows that the percentage of insured workers 65 and over who have chosen to retire with OASI benefits rose from 30 percent in 1945 to 93 percent in 1974. This rise is partly explained by rising living standards, but also by legislated increases in benefits, the accumulation of larger earnings credits by workers, fewer employment opportunities for the elderly as a result of the shift from agriculture to urban jobs, and the increase in the average age within the elderly population.

The rapidity of the decline in labor force participation of older men in recent decades has been larger than expected. Persons could have taken the increased leisure resulting from economic growth in the form of a shorter work-week or longer vacations rather than in early retirement. It was thought that most older persons would resist retirement because of the low level of OASI benefits, the sharp drop in total income

TABLE 4

Percent of the Population 65 and Over Insured by OASI Selected Years, 1941-1974[a]

Year	Number of Insured Workers 65 and Over[b] (in thousands)	Population 65 and Over (in thousands)	Insured Workers as a Percentage of Population 65 and Over
	(1)	(2)	(3)
1941	548	9,288	6%
1945	1,244	10,494	12
1950	2,164	12,287	18
1955	5,306	14,069	38
1960	8,468	16,679	51
1965	10,849	18,405.	59
1970	12,947	20,156	64
1974	14,707	21,824	67

[a] Hawaii and Alaska included, starting in 1959.

[b] Does not include dependents.

Source: U.S. Social Security Administration (1975, p 79); and U.S. Bureau of the Census (1960, p. 8; and Series P-25: 1971, p. 2; 1972, p. 5; and 1976, p. 3).

upon retirement, and possible social and psychological difficulties resulting from giving up employment (Kreps and Spengler, p. II-362).

The historical decline in labor force participation of older men could have been caused by a worsening in the health of older men because modern medical care has increased the percentage of older persons living to an advanced age. Bowen and Finegan (1969, pp. 367-368) reported that the National Health Surveys showed that from 1958 to 1966 the fraction of men 65 and over reporting chronic activity limitation increased, but later reports (U.S. Public Health Service, 1962, p. 19 and 1973, p. 16) show that from 1959 to 1972 inactivity among older males because of bad health has decreased.

There is little evidence to support the conclusion that the difficulty in keeping and finding jobs is an important reason why more persons are retiring. Although outmoded skills resulting from technological change and the shrinkage in the number of self-employed might have caused increased unemployment of older persons, Sheldon (1958, pp. 53-60)

TABLE 5

Percent of Insured Workers 65 and Over Receiving OASI Benefits, Selected Years, 1941-1974

Year	Total	Men	Women
1941	20%	20%	25%
1945	30	29	40
1950	59	59	61
1955	71	70	75
1960	85	84	87
1965	89	89	89
1970	90	90	90
1974	93	94	92

Source: U.S. Social Security Administration (1975, p. 79).

concluded that this was not clearly supported by the available statistics. In an early empirical study, Long (1958, pp. 12-14, 162-164, 174-180) attributed the declining participation rate among older men to their displacement by younger persons and women workers because of the deficiency in the education of older workers as compared to these other types of labor. Although he concluded that OASI had not been a major reason for the decline in labor force participation of older men, most of the data which he analyzed ended in 1950 — about the time many changes were made in OASI and the sharp drop in labor force participation began.

The wider use by employers of compulsory retirement programs probably has contributed to the secular downward trend in the participation rates of older persons. Between 1951 and 1963 the percentage of male OASI beneficiaries who said that they left work because they reached compulsory retirement age rose from 11 percent to 21 percent (Epstein and Murray, 1967, p. 347). In a 1968 study of the men age 65 who had stopped working altogether and who were initially entitled to retired-worker benefits in the last half of that year, 52 percent gave compulsory retirement as the main reason for leaving their last job (Reno, 1971, p. 8). The answers to questions in interviews on compulsory retirement are less subject to bias than questions on health and are probably a good indication of the importance of compulsory retirement programs as a cause of the decline in labor force participation. The adoption of compulsory retirement policies by employers, however, is not unrelated to the expansion of the social security system. The preferences of workers as well as the goals of management influence the retirement-age policies of business firms because wages tend to be lower where working conditions are considered to be better. By establishing an eligibility age for receiving benefits, the social security system undoubtedly caused many workers to prefer retirement at that age.

The Effect of the Early Retirement Option. The importance of OASI as a cause of retirement is also indicated by the large response to the amendments to the Social Security Act permitting retirement before age 65. In 1974, about two-thirds of the women and more than half of the men retired before age 65. Not all have retired immediately at age 62. As shown in Table 6, by 1974, 44 percent of the insured men and 54 percent of the insured women between the ages 62 and 64 were receiving OASI benefits. After the early retirement option for women was introduced in 1956, census data show a larger drop in labor force participation of women at age 62 than in earlier censuses. Also, in the census following the introduction of early retirement for men in 1961, the labor supply of men at age 62 dropped more sharply than in previous censuses. Because it was thought that the principal reasons for retiring were bad health or difficulties in finding a job, the continuous increase in the percentage retiring early was not anticipated by SSA officials.[6]

TABLE 6

Percentage of Insured Workers 62 to 64 Receiving OASI Benefits, Selected Years, 1957-1974

Beginning of Year	Total	Men	Women
1957	16%	—	16%
1962	28	20%	41
1963	35	29	45
1970	39	34	46
1974	48	44	54

Source: Based on data in U.S. Social Security Administration (1975, p. 80).

It is not surprising that the percentage of women workers retiring early is larger than that of men. Women are more apt to engage in part-time employment than men and would be able to adjust their earnings more easily to the limit allowed by the work-income test. In addition, especially if a wife is approximately the same age as her husband, she has the inducement to retire at age 62 so as to receive the OASI benefit she has earned even though her husband has not yet retired. When her husband retires she may receive the dependent's benefit she is entitled to as a wife, adjusted for retirement prior to age 65.

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[6] See Bixby and Rings (1969, p. 3).

The actuarial reduction in benefits when a person retires at age 62 has not had the expected effect of discouraging withdrawal from the labor force (Lauriat and Rabin, 1970, p. 22). Benefits are reduced 5/9 of 1 percent for each month prior to 65 that a person elects as his starting date — this adds up to a 20 percent reduction for retirement at age 62. Actually, benefits are reduced somewhat more than this because the wage base on which benefits are calculated would usually be smaller. To some persons, receiving benefits three years early is attractive because of the uncertainty as to how long one will live. In addition, the opportunity to spread benefits over three more years may appear advantageous to those who value leisure highly or are able to work part-time during the additional years of retirement without losing benefits.

Effects of the Work-income Test. The negative impact of the work-income test on labor force participation is indicated by the shift that has occurred from full-time to part-time employment among older men. Table 7 shows that the percentage of employed males 65 and over working part-time (less than 35 hours per week) has increased from 20 percent in 1957 to 42 percent in 1974. Also, in 1963 approximately 60 percent of OASI beneficiaries aged 63 to 72, kept their earnings below the annual limit and about a fourth of them earned just below the maximum allowed (Sander, 1968, p. 5). In a 1968 sample of new beneficiaries who continued to work, it was found that 44 percent of the men who retired at 65 or older and 56 percent of the men retiring early with actuarially reduced benefits earned less than the maximum allowed without penalty (Lauriat and Rabin, 1970, pp. 15-16). Some beneficiaries earn more than the annual maximum allowed without penalty because they can increase their total income if they bunch their earnings in part of the year and still draw benefits for the rest of the year. Bowen and Finegan (p. 284) concluded that older persons often responded to the work-income test by part-year withdrawal from the labor force rather than by reducing hours worked per week. Instead of viewing part-time and part-year employment of elderly persons as rational responses to social security regulations, SSA studies have usually concluded that the reason some beneficiaries exceed the earnings limit is that they are unable to control earnings precisely, enjoy working, or urgently need the extra income.[7]

In 1960, the Social Security Act was amended so that benefits would

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[7] See Sander (1968, pp. 4-6) and U.S. Social Security Administration (1960, pp. 5-6).

TABLE 7

Voluntary Part-time and Full-time Employment Males 65 and Over, 1957-1974

(annual averages)

Year	Number Employed (in thousands)	Type of Employment	
		Voluntary Part-time	Full-time[a]
1957	1,580.0	20.0%	80.0%
1960	1,424.2	26.9	73.1
1965	1,418.1	30.6	69.4
1970	1,490.0	36.5	63.5
1974	1,335.5	42.4	57.6

[a] Thirty-five hours per week or more during the survey week.

Source: Based on data in U.S. President, *Manpower Report* (1968, pp. 244-245; and 1975, pp. 245-246).

be reduced $1 for every $2 of earnings between $1,200 and $1,500 and $1 for every $1 of wages above that. These measures, and particularly the $1-for-$2 penalty, were intended as work-incentive measures. Previously, insured persons forfeited their entire benefit if earnings exceeded a specified limit. Sander's study of 1963 data found that most workers did not differentiate between the $1-for-$2 and the $1-for-$1 penalty.[8] These penalties are both very high, especially when social security and income taxes as well as working expenses are considered.

Over the years, the earnings test has been liberalized in some ways and made more severe in others. The monthly earnings allowed without penalty have been increased from $14.99 in 1940 to $230 in 1976 — an increase of 15 times, compared to the increase in average gross weekly earnings in manufacturing of more than 7 times. Since 1960, only a fraction of one's benefit need be forfeited if monthly earnings are above the maximum amount allowed; also, on reaching age 72 there is now no penalty for working. On the other hand, as the coverage of OASI expanded, opportunities to evade the work-income test legally by working in uncovered jobs were drastically reduced — and now benefits are penalized for any type of earnings even if a person is employed outside of the United States. Also, after the annual earnings test was adopted in

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[8] See Sander (1968, pp. 3-6).

1954, large excess earnings in any month were not only deducted from benefits in that month, but had to be carried over and deducted from benefits in other months in which earnings exceed the amount allowed without penalty.

Labor Force Participation After Age 72. The removal of the work-income test at age 72 provides another opportunity to test the effect of OASI on labor force participation. Gallaway found that the percentage of employed men entitled to OASI benefits increased from 25.4 percent at age 71 to 27.2 percent at age 72,[9] and in the 1963 Survey of the Aged, 6 percent of males aged 65 through 72, entitled to benefits, had full-time year-round jobs compared to 7 percent of those aged 73 and over (Epstein and Murray, 1967, pp. 91, 336). In both of these studies, the increase in employment of male beneficiaries over 72 could have been the result of insured workers becoming eligible for benefits rather than an increase in total employment of older men. Stronger evidence of the impact of the removal of the work-income test at age 72 was obtained by Bowen and Finegan (1969, pp. 277, 285-286). They examined the 1/1000 sample of the 1960 census for all persons age 65 and over, adjusted for certain factors. The labor force participation rate for men declined from age 65 to 71, but then increased from 31.5 percent at age 71 to 34.4 percent at age 72 and 35.2 percent at age 73. However, because the standard errors of their regression coefficients were relatively large, these results may not accurately show the effect of the removal of the work-income test on labor force participation of men over 72. Viscusi and Zeckhauser have made a cross-section analysis of labor force participation data for both men and women age 60 to 74 from the 1960 Census using a different procedure from that of Bowen and Finegan.[10] The three explanatory variables were age, a 65+ dummy, and a 72+ dummy. The 72+ dummy was intended to capture the influence of the discontinuance of the work-income test once a person reaches age 72. They found that the 72+ dummy had a significant positive sign, implying that removal of the work-income test influenced the employment of persons reaching age 72. The effect of the removal of the work-income test was also reflected in a slow-down in the rate of decline in labor force participation for those age 72 and over.

The Effect of Different Levels of Replacement Ratios. Several statistical studies have found that retirement is more common among persons in low-income occupations than among persons with high incomes (Steiner and Dorfman, 1957, p. 50; Gallaway, 1965, pp. 13-17; Epstein, 1966, pp. 6-7; Epstein and Murray, 1967, pp. 102-103; and

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[9] See Gallaway (1965, p. 23). See also Gallaway (1966 and 1967) and Taussig's comment (1967).

[10] See Viscusi and Zeckhauser, Chapter 9, Employment of the Elderly (1975, pp. 75-79).

Bixby and Rings, 1969, pp. 13-14). One should expect retirement to be more common among lower-income groups because their OASI replacement ratios are higher than those of persons with high incomes, and persons with low earnings can increase their total income by taking their social security benefits and working part time. In two cross-section studies of different countries there was also a significant inverse correlation between the average ratio of benefits to income-before-retirement and the proportion of elderly men in the labor force (Gordon, 1963, pp. 436-458; Pechman, Aaron, and Taussig, 1968, pp. 296-304). That retirement is less common among higher-paid occupations has been considered surprising by some students of social security because higher-paid persons have more resources for retirement. Most SSA studies have concluded that the reasons why higher-paid men do not retire as readily as those who are low paid are that their work is less demanding physically, the jobs are more interesting, they have better health, and their retirement is less likely to be compulsory.[11]

IV. MULTIPLE-REGRESSION ANALYSES

In addition to OASI, other factors such as the compulsory retirement policies of employers, the deterioration in the health of persons as they get older, rising standards of living, and the shift from agricultural to urban jobs undoubtedly have affected labor force participation among elderly persons. Several studies using multiple regression analysis have been made to determine the relative importance of these various factors

Bowen and Finegan (1969, pp. 281-285) included in their comprehensive study of labor force participation an analysis of the decline in labor force participation of men between ages 64 and 67 using a multiple regression analysis they had set up for men age 55 to 64. They estimated that about a third of the drop between ages 64 and 67 was the result of the increase in *other income* (primarily social security benefits). Only a small portion was the result of three years of aging (health) — a factor the SSA has considered important. About half of the decline could not be attributed to the factors for which data were available. The large unexplained portion could include the effect of such factors as OASI's work-income test, the compulsory retirement policies of employers, and the increased acceptance of retirement at age 65. Although Bowen and Finegan's study is interesting, their results must be viewed with some caution because social security benefits were used as an exogenous factor. In the social security system, benefits actually depend on retirement.

Bowen and Finegan (pp. 355-358) also used a multiple regression to determine the factors contributing to the secular decline in labor force participation of older men from 1948 to 1965. They estimated that, after adjusting for demographic factors, roughly three-fifths of the secular decline in labor force participation of older men during this period was the result of the increase in income other than earnings. According to Bowen and Finegan (pp. 375-378), the reason why the participation rate of older women, shown in Table 3, has not declined is that during the postwar period various factors have caused the number of working women of all ages to rise sharply and these factors have tended to offset the general trend toward earlier retirement.

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[11] See Palmore (1964, p. 4), and Epstein and Murray (1967, pp. 102-103).

Factors affecting the long-run decline in labor force participation rates have also been studied through the use of multiple regression analysis by Viscusi and Zeckhauser (1975). They examined both annual data — for 1952 to 1971 — and monthly data — for 1966 to 1972 — on participation rates of persons 65 and over, stratified by both race and sex. They found that except for Negro females, increases in average social security benefits resulted in sizable reductions in labor force participation rates, and this was the most influential variable in their regressions. Also, except for Negro females, increases in the amount of earnings allowed before one begins to lose benefits increased labor force participation. The authors concluded that the lack of any effect of social security on the employment of Negro females was the result of the relatively large portion of Negro females who were not social security beneficiaries because they had not worked in covered employment. In their regressions, they also found that except for a positive response to inflation, labor force participation of older persons was not sensitive to job-market conditions as measured by the rate of unemployment in the economy and the ratio of average hourly earnings to a moving average of past wages.

Boskin (1975) made a study of the effect of social security on labor force participation using statistical techniques that are more refined than those that have been used in other studies. He used data from the Survey Research Center's Panel Study of Income Dynamics in which the same households were reinterviewed annually for the five years 1968 through 1972. The households in the sample were headed by persons initially aged 61 through 65. Using a Markov model of retirement behavior, he found that both increases in old-age benefits and increases in the amount of income forfeited because of the earnings test increased the probability of retirement. His results suggest that a decrease in the implicit tax rate of the work-income test from one-half to one-third would reduce the annual probability of retirement by about 50 percent. Boskin's conclusions are also very different from the conclusions of SSA studies in regard to health as a factor affecting retirement. SSA studies have usually concluded that at least half of the persons sampled retired involuntarily because of poor health. Boskin measures health by the number of hours ill during the year rather than by the judgment of their own health by the persons sampled and found that it was not a major reason for retirement.

The principal regression analysis of early retirement has been made by Quinn (1975). He used data from the SSA's Longitudinal Retirement History Survey for 1969 and included in his analysis a large number of variables. His conclusion that health was one of the three most important factors causing early retirement is in agreement with the studies by the SSA, but his conclusion that eligibility for social security benefits and eligibility for a private or other public pension were the two other factors that were of major importance differed from SSA findings. Quinn's results also differed from those of the SSA in regard to the role of labor-market conditions in inducing retirement. In SSA studies, the difficulty persons have finding jobs is the second most important reason — after health — why older persons retire. Quinn uses two variables to measure local labor-market conditions — the unemployment rate and the percentage change in the unemployment rate. Neither had a significant effect on labor force participation, although the unemployment rate had a minor influence on the retirement decision of men. In addition, the wage rate was found to be unimportant for men, but important for white single women. Unearned income affected the retirement decision of white married men and white single women, but was not as significant as reported in other studies. Several measures of working conditions had only a minor influence on the labor force participation of older persons.

V. CONCLUSION

The estimates that have been made of the sacrifice in real output resulting from the effect of OASI on retirement indicate that it is small. Feldstein (1974, p. 924) estimated that if the labor force participation rate of the elderly were the same now as in the 1930s, the increase in the total labor force would be less than 3 percent. In an earlier study, Gallaway (1965, pp. 41-48) calculated that for the 12-year period from 1949 to 1961, the reduction in GNP caused by induced retirement was 2.4 percent — a .2 percentage point decline in the annual growth rate. These estimated losses of output could easily be offset by the increased efficiency of business firms resulting from the earlier retirement of workers. Compulsory retirement programs and OASI undoubtedly assist many employers in solving personnel problems associated with aging. It is not easy for employers to decide which older employees should be kept and which should not be, and it may be less costly for management simply to compel all older employees to retire. Also, it may be difficult to hold able young workers on the job if promotion is blocked by older workers.

The significance of the stimulus to retire resulting from OASI is its effect on the economic condition of elderly persons rather than its effect on the total output of the economy. To encourage labor force participation of older persons, the 1974 Advisory Council (1975, pp. XV, and 22-23) recommended that the work-income test be liberalized. The Council recommended that instead of reducing benefits by one dollar for every two dollars of earnings above the exempt amount, one dollar should be withheld for every three dollars of earnings between the exempt amount and twice the exempt amount, and one dollar for two dollars above that level.

The sharp difference between the conclusions of the SSA studies using the interview technique and the conclusions of studies of the effect of OASI on labor force participation made by persons outside the SSA ought not to be surprising. Looked at realistically, persons within the SSA would not be expected to conduct studies which blame OASI for a decline in labor force participation of elderly persons, but would be expected to want to promote the organization in which they are employed.[12] Niskanen in *Bureaucracy and Representative Government* (1971) has suggested this type of motivation for government employees and the possibility of conflicts between the interests of government employees and the interests of the public.

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[12] A similar difference in the research on minimum wages by economists in the U.S. Department of Labor and by non-government economists has been noted by Peterson and Stewart (1969, pp. 153-4).

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PREPARED STATEMENT OF DR. MARSHALL R. COLBERG, PROFESSOR OF ECONOMICS, FLORIDA STATE UNIVERSITY

Under the social security retirement test a person who continues to work after qualifying for benefits loses all or part of the benefits in any year when earnings exceed a specified amount. For 1980 this amount is $5,000 for those aged 65 to 72. It is scheduled to rise to $5,500 in 1981, and to $6,000 in 1982. In real terms the scheduled liberalization is not impressive, however, and may turn out to be negative because of the high inflation rate.

For persons under 65 the permitted unpenalized earnings in 1978 were only $3,240 with automatic adjustment for inflation after that date. This test seems to be especially inappropriate since a large number of persons have chosen 62 as the age to receive OASI benefits. This action by Congress in 1977 was unjustified, I believe. Actions of some of the earlier Congresses were even more harsh. In the early years of social security in the United States, complete forfeiture of benefits occurred in any month when there was any work in covered employment. During World War II, when maximum work effort by all age groups should have been encouraged, the entire monthly retirement benefit was lost if as little as $15 was earned.[1]

At the heart of the problem is the ambivalence of social security goals. Those who think of Old Age and Survivors Insurance as primarily a device for the redistribution of income tend to favor a strict earnings test so the benefits do not go to persons with large earned incomes. Those who regard OASI benefits as primarily a compulsory savings program see no proper role for a retirement test since they regard government annuities as an alternative to private annuities that could have been received without regard to subsequent earnings.

The case for a retirement test is greatly weakened by the fact that any amount of non-labor income—dividends, interest, rents, and royalties—can be received without a reduction of social security benefits.

Although the distinction between earned income and other income is basic to the retirement test, it is not a clear one. Most labor income is actually interest on "human capital." For many persons at various times in their lives, investment in material and human capital are rational alternatives. However, interest on investment in higher education, vocational training, and on-the-job training encounters the retirement test, while interest on material capital escapes the test. If anything, preference should be given to earned income since one has to work to collect the interest, and human capital cannot be inherited. The federal income tax has rather recently moved in the opposite direction, favoring earned income for low-income families with children. The income tax, for all its shortcomings, has provisions to soften the blow of traveling and other expenses related to work, medical bills, casualty losses, alimony payments and other unfavorable events of the year. The social security retirement test does not. Further, the test is more onerous in areas of the country where the cost of living is high. Even without considering Alaska and Hawaii, the cost of living can vary by as much as 30 percent from one city to another within the country.

It is not surprising that Alaska withdrew its state employees from the social security system as of January 1, 1980. The retirement test in real terms is especially low there because of the high price level. Also, the "tilt toward adequacy" in the social security benefit schedule is especially unfavorable to Alaska with its high wage rates in dollar terms.

About 130 thousand state and local workers in the United States have "opted out"of social security. It is certain that one consideration in may withdrawals has been the retirement test since such an earnings test is unlikely to be included in a new plan that excludes a social security component. Repeal of the retirement test would do much to remove this element of instability to the system.

Frequent changes are made in the law governing social security. It is not obvious that all are improvements. The monthly earnings test was eliminated by Congress in 1977 except for the first calendar year of retirement. Prior to this change, persons with irregular, often unpredictable earnings from part time jobs were greatly assisted by being able to draw OASI benefits in the poor months without regard to what the year's earnings might turn out to be. They may now be inhibited in "off seasons" from trying to earn extra money because the yearly test alone can require their sending back a great deal of the benefits already collected. The monthly test as it existed prior to 1977 should be restored.

Opponents of repeal of the retirement test at age 65 usually do so on grounds of the added cost to an already strained system. This added cost has been placed at 2 to 3 billion dollars a year, although these figures may be somewhat outdated. This cost would be in part offset by larger payroll, income, and other tax collections to the extent that more work effort would be provided by those over 65 if the test were eliminated at that age. I believe the extent of this extra work is usually underestimated. Admittedly, it is hard to calculate with confidence. I believe that between one-third and one-half of the added cost of OASI benefits would be recovered by added federal tax collections from men and women over 65. It is not usually recognized that an important consequence of repeal of the retirement test would be greater honesty in reporting earnings to the IRS. There is cross-checking between income tax and social security reports. The "price of honesty" is now so high that a sort of underground economy is promoted among the elderly. This takes the form both of avoiding employers who report dollar earnings to the IRS and, more legitimately, of working for income in kind.

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[1] Marshall R. Colberg, "The Social Security Retirement Test: Right or Wrong?" (Washington, D.C., American Enterprise Institute, 1978), p. 3.

The whole idea of the cost of repeal of the retirement test is a fallacy based on a narrow accounting view. Extra work effort by the over-65 group would increase the real national product and real income per capita. It is difficult to trace all of the effects which would include some improvement in state and local finances and probably a small reduction in the rate of inflation due to more output. But properly computed, the cost to the nation would be negative rather than positive.

APPENDIX 3

Attachments to the prepared statement of Senator Barry Goldwater

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ATTACHMENT I

Persons aged 65 and over eligible for OASDI benefits on January 1, 1984, and affected by the retirement test in 1983

[Estimated number of persons]

	Millions
Total number subject to the retirement test in 1983 [1]	10.8
With no earnings for 1983	7.6
With annual earnings for 1983 [2] of $6,600 or less [3]	2.1
With annual earnings for 1983 [2] above $6,600, but with no benefits for 1983 withheld because of the retirement test [4]	.2
With annual earnings for 1983 [2] above $6,600 and with some or all benefits for 1983 [5] withheld because of the retirement test	.9

[1] Generally persons attaining age 70 in January 1983 or earlier are not subject to the retirement test in 1983; persons under age 70 at the end of January 1983 are subject to the retirement test during some or all months in 1983. An exception to this is a spouse age 70 or over of a worker under age 70 at the end of January 1983—such spouses are subject to the retirement test in 1983.

[2] Excluding earnings in or after the month of attainment of age 70, for workers attaining such age in 1983.

[3] The exempt amount for persons aged 65–70 in 1983 is assumed to be $6,600.

[4] These are people attaining age 65 in 1983 who have no benefits withheld for months in or after the month of attainment of age 65, because they have no earnings, or have wages not exceeding $550 a month, or do not perform substantial services in self-employment in such months.

[5] As used here,"benefits for 1983" means those benefits for all months in 1983 excluding months prior to the month of attainment of age 65.

ATTACHMENT II

DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE,
SOCIAL SECURITY ADMINISTRATION,
July 5, 1979.

Memorandum to Dwight K. Bartlett, III.
From: Harry C. Ballantyne.
Subject: Proposal To Eliminate the Retirement Test for Workers Aged 65 and Over.

Under the subject proposal, the retirement test would be eliminated for workers aged 65 and over, beginning January 1983. The resulting additional amount of OASDI benefit payments for months in calendar year 1983, over and above benefit payments under present law, is estimated to be $2.1 billion. After 1983, the additional amount of benefit payments would increase gradually, but at a slower rate than total OASDI benefit payments.

This estimate reflects the effect of the reduction in the age at which the retirement test ceases to apply under present law, from age 72 to age 70, beginning in 1982. The increases in the annual amount of earnings exempted from the test, which are scheduled under present law for workers aged 65 and over, are also reflected in the estimate. The exempt amount for workers aged 65 and over is scheduled to increase to $6,000 in 1982. Under the intermediate assumptions in the 1979 Trustees Report, upon which the estimate in this memorandum is based, the exempt amount for workers aged 65 and over is assumed to increase to $6,600 in 1983.

HARRY C. BALLANTYNE,
Acting Deputy Chief Actuary.

ATTACHMENT III

THE FLORIDA STATE UNIVERSITY,
Tallahassee, Fla., September 12, 1979.

Senator BARRY GOLDWATER,
U.S. Senate,
Washington, D.C.

DEAR SENATOR GOLDWATER: I am glad to be asked to comment on Appendix 5 of the Report of the Panel of Consultants to the 1979 Advisory Council on Social Security.

(1) I do not feel that the retirement test was made "very much more lenient for those ages 65 to 71" by the 1977 legislation. This is true for 1978 but if we experience a 10 percent inflation rate for the four year period 1979–1982 the test will rise only from $4,000 to $4,098, by 1982 measured in 1978 dollars. At a not-improbable inflation rate of 11 percent, smaller real earnings will be permitted in 1982 than in 1978. Most, or all, of the alleged leniency is "money illusion."

(2) The Panel (p. 89) estimates the cost of removing the test in 1982 to be about $2 billion. This cost should not be compared with the $454 million per year that I estimated as additional payroll and income tax collections, since wage rates and the payroll tax rate will be considerably higher in 1982 than in 1977. Although I do not consider the minimum wage to be the correct wage to assume for elderly workers (as was done by the Panel) the scheduled increase in the minimum wage provides a way of quickly estimating the increase in income of those over 65. This increase is 57 percent. Assuming no change in the average income tax rate for the older workers, this income increase would bring in about $122 million in added income taxes and $206 million in added payroll taxes (at a 6.70 percent rate in 1982 compared with 5.85 percent rate in 1977). This would bring my estimated total of $454 million for 1977 up to $782 million for 1982. This needs to be adjusted downward because it includes added collections for those aged 70; 71, and 72 who would already be exempt under present legislation. Since about 19 percent of the income and payroll taxes were collected from the 70-and-over group in my original calculation, deducting 19 percent from $782 million gives an estimated (roughly!) tax collection of $633 million if the retirement test were repealed in 1982 at age 65.

(3) A factor that might well bring the amount recouped to a higher level than $633 million would be greater honesty in reporting income for income tax purposes on the part of social security recipients. The "price of honesty" is now especially high because honest disclosure can increase income tax liability and also reduce social security benefits because of cross-checking between income tax returns and earned income statements made to the local Social Security office. The lower "price of honesty" which would accompany repeal of the retirement test would increase income tax receipts. The importance of this is hard to judge but it seems to be conservative to say, that it would bring the government's recoupment to at least one-third of the estimated $2 billion cost.

(4) The Panel's minimum estimate of 5 to 10 percent of cost seems much too low. While I cannot easily defend my estimates as being "best" I do believe my chart on added labor force participation looks reasonable and that there would not be such widespread dissatisfaction with the retirement test if it really had so little influence on the desire to work. (I have some letters protesting the test and I am sure you have great numbers.)

(5) Looked at in real terms there would be a negative cost to the nation in eliminating the retirement test, although there would be distributional effects that some persons would not favor. (The extremely progressive benefit schedule holds down the extent of such redistribution, however.) Real output of the economy would rise because of added labor force participation by the over-65 group. (Any adverse effects on younger workers would only partially offset this output gain.) It is probably unwise to pay attention just to dollar receipts and expenditures, rather than to the "real" economy. If, for example, SSI were moved into general revenue financing, the financial situation of OASI would look better.

The estimates that I have made above are rougher than I would have liked because I am presently busy writing a paper on regional aspects of minimum wage legislation for the American Enterprise Institute, which has to be finished this month.

After the minimum wage paper is finished I will return to work on a book for AEI "Universal Coverage Under Social Security." One problem will be to secure as speedily as possible the Federal Government's report on the subject due in December 1979.

I hope the above is of some use to you.

With best wishes,

Marshall R. Colberg,
Professor of Economics.

ATTACHMENT IV

From: SOCIAL SECURITY BULLETIN, Vol. 42

Tax Impact From Elimination of the Retirement Test

by Josephine G. Gordon and Robert N. Schoeplein*

The OASI eligibility provisions include a retirement test (or earnings test), and in 1979 aged beneficiaries who are under age 72 give up $1 in current benefits for each $2 of annual earnings above $4,500. If the retirement test were eliminated, total OASI payouts would increase because aged workers would no longer forfeit benefits. Aged workers also might increase earnings or delay retirement if this penalty on work effort were removed. Increased earnings would generate additional OASDHI taxes and individual income taxes. This article examines the fiscal effects on OASI benefit payouts and increased tax receipts if the retirement test were eliminated.

This article estimates the initial-year net changes in social security (OASDHI) tax receipts and Federal individual income-tax receipts if the social security retirement (or earnings) test were eliminated for individuals aged 65–69. Individuals under age 65 are not considered.[1] The expenditure and tax estimates shown are for 1978 but with the 1982 earnings ceiling adjusted to 1978. Persons aged 70 and 71 will not be subject to an earnings test in 1982 and are therefore excluded from the study. Thus, in 1978 levels, the budget impact of changing the 1982 retirement test for persons aged 65 and over is estimated.

Under the present provisions of the Social Security Act, elderly workers insured to receive OASI benefits at age 65 who earn income above an allowable amount will forfeit their current benefits at a rate of $1 for each $2 of excess earned income. Workers aged 62–64 who retire early and forfeit OASI benefits are compensated by actuarially adjusted future benefit increases equivalent to current benefits forgone, but the adjustments to workers aged 65 and over represent only a fraction of benefits forgone because of the retirement test.

The tax impact estimates shown here are based on a 1978 sample population but incorporate known 1982 tax provisions. Current individual income-tax statutes are assumed to remain in effect in 1982, and the $6,000 allowable earnings ceiling in 1982, adjusted to 1978, is used. The 1982 social security tax rates are used. The simulated net changes in the budget are therefore designed to reflect two 1982 provisions of social security law: (a) A liberalization of the retirement test under the 1977 amendments between now and 1982 that reduces benefit costs in eliminating the test and (b) higher OASDHI tax rates that increase the tax revenue per dollar of additional taxable earnings generated by removing the earnings test.

The social security actuaries estimate that the additional benefit payout cost to the OASI trust fund, if the retirement test were eliminated for workers aged 65–69, is approximately $2.1 billion for the 1982 earnings ceiling adjusted to 1978. It is estimated here that the net changes in work effort by elderly workers still actively employed (part time and full time), if the test were eliminated, will generate $139 million in OASDHI tax receipts and $191 million in individual income-tax receipts or about 16 percent of the $2.1 billion increase in outlays. If 10 percent of workers aged 65–69—either fully retired or contemplating retirement—were to be fully employed in the labor force in 1978, these workers would generate an additional estimated $540 million in social security taxes and $786 million in individual income taxes. With these elderly current workers and continuing or returning fully retired workers considered together, the estimated net increase in social security tax receipts represents about 32 percent of additional benefit payouts, and individual income taxes generate about 47 percent of additional benefits. The projected increases represent about 79 percent of estimated increased OASI benefits.

The study's methodology reflects the precedent of others who recently have studied the retirement test. Because there is no previous experience with the elimination of this test, cross-sectional data based on elderly workers' responses to net wage-rate changes under other circumstances, such as the effects on net earnings under negative income-tax experiments, are used. No evaluation of labor-market demand conditions is made. That is, it is assumed that elderly individuals who want to expand work effort or seek new employment because of the elimination of the retirement test will find jobs and that other labor-force participants will not be displaced or have their wage rates depressed by an expanded number of elderly workers.

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* Office of Research and Statistics, Office of Policy, Social Security Administration. The cooperation of Roy Wyscarver, Office of Tax Analysis, Department of the Treasury, in programming and providing tax revenue estimates from the Treasury Individual Income Tax Model is acknowledged, as is the constructive criticism and suggestions from Rudolph Penner, member of Consultant Panel of Actuaries and Economists, and from Benjamin Bridges, Jr., Lucy Mallan, and David Podoff of the Office of Research and Statistics.

[1] The labor-force response of the group aged 62–64, since many are not receiving early retirement social security benefits, poses additional estimating problems. For working couples where the principal wage earner is aged 65–69, the working spouse, regardless of age, is considered in some specific calculations.

In this study, workers aged 65–69 who are active in the labor force are treated separately from fully retired workers (former workers who have no earned income in 1978). Most earlier studies considered only the response of elderly workers still active in the labor force. About 70 percent of the workers aged 65–69 covered under social security are fully retired. Some individuals now fully retired may return to the labor force if the earnings test is eliminated; other workers now reaching age 65 and contemplating retirement may postpone their retirement 1 or 2 years. A working assumption that, in a given year, 10 percent of such individuals either will return to work or continue working full time is adopted here.[2] (Estimates are also presented for a 5-percent assumption.) This assumption is critical to the tax-impact estimates, as these returning or continuing workers would account for about 80 percent of the total estimated net tax increases under the 10-percent assumption.

Previous studies also limited the tax-impact estimates either to surveys of married men or to projections based on average earnings of the aggregate labor force. This study uses the Individual Income Tax Simulation Model of the U. S. Treasury (1975 data base, statistically adjusted to 1978 levels and tax law).[3] This simulation model provides a basis for analyzing earnings of individuals, couples with only a single wage earner, and working couples as tax units. (See Technical Note No. 2 for further description of Treasury tax simulation model.)

The following section of the article focuses on possible responses by workers aged 65–69 who are still active in the labor force. The impact on individuals aged 65–69 who are fully retired in 1978 is discussed next. The concluding section integrates the tax-impact estimates for both working and currently retired individuals and examines the sensitivity of critical working assumptions.

Response by Working Individuals Aged 65–69

If the earnings of an elderly worker exceed the permissible earnings ceiling, the penalty tax of 50 percent is imposed until the worker's social security benefits under the current law are exhausted. The net wage concept used here is the gross wage minus individual income taxes, social security taxes, and the allocated forfeited social security benefits. A repeal of the current retirement test, therefore, would have the effect of more than doubling the net wage rate over the range of taxed earnings.[4]

When hourly wages of workers rise, two components determine consequent labor-supply response. The more attractive wage rate encourages an individual to expand work effort and thus to substitute more work hours for reduced leisure hours. At the same time, individuals in the taxed range realize more income for a given amount of work effort. This income effect induces workers to reduce the amount of labor they supply because of their higher incomes. The direction of change in an individual's work effort, if any, is the net of these two opposite-direction effects. Workers with high annual earnings who previously forfeited the entirety of current social security benefits then would receive these benefits. These high-earnings workers, therefore, would be wealthier by the amount of the retirement benefits and might reduce work effort in response to higher family incomes.

The behavior of workers following changes in net (after-tax) wages depends on sex, age, marital status, unearned income sources, assets, and other considerations.[5] A wife, for example, has been shown to respond more dramatically in adjusting work effort to a change in family income than the husband. The wife might, in fact, drop out of the labor force altogether as her husband's earnings increase.

The literature on labor-supply response to earnings changes is vast.[6] In narrowing the range of worker response to provide some guidance for policy, one must evaluate why the estimates differ from one study to another. Some studies focus on the estimated or actual effects of negative income-tax experiments. Although older workers were included in some negative income-tax analyses, subjects tended to be young and observed earnings tended to be lower than the earnings range relevant for the retirement test. Other studies focus on worker response to wage-rate changes at all earnings levels within the sample, but the highest individual or family earnings sampled were constrained to a low ceiling. Some studies use as "wage rates" the individual's wage rate as reported for the week before an interview; other reports employ wages and fringe benefits as reported over a longer period such as 6 months. These considerations are taken into account together with the availability of elasticity estimates specific to elderly individuals and elderly couples with one or both spouses working. The rationale for the specific labor-response multipliers is discussed later.

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[2] Phillip Cagan, **Effect of the Elimination of the Retirement Test on OASDI Revenues** (Working Paper for the Panel of Actuaries and Economists, 1974 Advisory Council on Social Security), Social Security Administration, September 18, 1974.

[3] Department of the Treasury, Office of Tax Analysis.

[4] Income-tax deductions will vary among individual workers. In converting net wage elasticities to labor-response multipliers, abstracts were made from income taxes and it was assumed that removal of the 50-percent implicit earnings-test tax penalty would double the net wage. The net wage multipliers and the consequent net increase in taxes were therefore understated somewhat, although the understatements are not believed to be significant. Given the procedure in selecting net wage elasticities, such further fine tuning would be pretentious.

[5] The net change in work effort is further referred to as a labor-supply multiplier. The value of this multiplier can be thought of as an average response over all workers in a particular class to a wage change.

[6] Summary tables appearing in Glen C. Cain and Harold W. Watts (editors), **Income Maintenance and Labor Supply**, 1973, table 9.1, and Stanley Masters and Irwin Garfinkel, **Estimating the Labor Supply Effects of Income Maintenance Alternatives**, 1977, table 5.7, demonstrate the wide range of labor-supply elasticities estimated in 13 separate recent studies. Though the methodological and econometric problems inherent in estimating labor-supply elasticities have become an intriguing academic subject, this is no solace to policy analysts who must make tax-revenue estimates based on some specific elasticity figures.

All labor-supply effects presume a set of underlying assumptions about labor-demand conditions and underlying labor-market structure. In this study it is assumed that the economy will provide increased employment for the elderly without concurrent adverse effects on other workers. It is also assumed that the structure of the labor market for elderly workers remains unchanged from the recent past. That is to say, new government incentives to hire the elderly are not assumed. Consequently, the emphasis is placed on the labor-supply side of the market, given the above demand conditions.

Stratification

All empirical evidence of workers' labor-supply response to a change in the wage rate indicates that annual earnings as well as marital status are important determinants of the change in hours worked. The data file of the Department of the Treasury makes possible identification of the earnings both of principal wage earners and working spouses, so that each may be treated independently and also as a joint household with regard to labor-supply response. The sample of workers has been divided into three broad categories according to marital status and current labor participation. Each broad category, in turn, is subdivided into four relevant income classes.

Initially, the elderly population is divided into three all-inclusive groups of principal taxpayers (or potential taxpayers): Individuals, principal taxpayer with spouse earning zero income, and principal taxpayer with spouse earning greater than zero income.[7] To account for the variation in behavior related to the level of earnings, the three groups are further divided into four earned-income categories.

Workers earning below the $4,500 earnings ceiling would not receive any additional social security benefits if the retirement test were to be eliminated. Thus, they would experience no income effect. The labor-market behavior of workers earning between $1-3, 600—substantially less than $4,500—would not be expected to change as a result of a change in the net wage rate. These workers are therefore assumed to be unaffected by elimination of the test.

The labor market may not be perfectly flexible, however, as workers may not be able to control their hours of work so that earned income is just below the $4,500 ceiling or to accept work effort that would generate earnings above $4,500. Moreover, workers exceeding the allowable earnings ceiling have burdens in the form of social security forms, disrupted social security benefits, and other considerations.

This group who would be potentially affected by elimination of the earnings test because of their proximity to the earnings ceiling is represented by workers currently earning $3,601-4,500. These individual workers, having forfeited no benefits, would then experience only a substitution effect on the portion of their earnings above the $4,500 ceiling that would have been taxed before the repeal.[8]

The third class is composed of those workers earning more than the $4,500 ceiling who are subject to the tax on the earnings above the ceiling but not enough to lose all their benefits. This group would experience both a positive substitution effect and a negative income effect.

Because some families have one beneficiary and others have two beneficiaries and because of the way the social security law treats beneficiaries with a working spouse, determination of the upper boundary on this classification is more complex.[9] The figure $10,464 represents the level of 1978 earnings at which all benefits are forfeited by single individuals who would receive the current average annual social security benefits when benefits are not reduced because of the current earnings test.[10]

This figure would thus become the upper boundary for all individuals not filing joint returns. Since spouses not qualifying for their own benefits receive half the benefits of the worker, the figure $14,482 is the level at which benefits disappear for worker and nonworking spouse, on the average; $14,482 has therefore been chosen as the upper boundary for this group. When both worker and spouse are employed, however, the earnings of the wife above the ceiling will only affect the amount of her benefits and not those of the husband. Both workers in families affected by the earnings ceiling were therefore treated separately, and the lower $10,464 level at which all benefits are exhausted was applied to each of them.

The fourth class of workers aged 65-69 consists of all workers with earnings above their respective upper boundaries. These are individuals earning more than $10,464, primary wage earners earning more than $10,464 with a working spouse, and couples with joint returns and only one worker with earnings above $14,482. This class of workers currently would receive no OASI benefits because of their high earnings. They would receive the entirety of their benefits if the retirement test were eliminated and would therefore be subject to an income effect, reducing work effort.

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[7] The division of workers is based on type of individual income tax return rather than on sex. The individual returns include those of unmarried men and unmarried women. The relevant literature (specifically, Boskin) indicates that labor-supply elasticities of single elderly women workers are approximately equal to single elderly male workers. No adjustments for sex are necessary in this instance.

[8] For two-worker couples, cross-elasticity effects also must be considered.

[9] Although it is possible for families to have more than two beneficiaries, for purposes of the study, the two relevant members are the worker and the spouse.

[10] The figure of $10,464 is the adjusted $4,500 allowable earnings plus twice the SSA-estimated 1978 average OASI benefits for retired individual workers aged 65-69.

Estimates

To estimate new tax revenues generated from elimination of the retirement test, one must make specific assumptions regarding labor-supply responses to wage changes for the sample of elderly workers. These assumptions are selectively chosen from studies on labor-supply behavior.

As indicated, previous studies on labor-force response in work effort to changes in net wages have been confined to cross-section analyses of observed or constructed negative income-tax experiments or to statistical analyses of general labor-force behavior. Two rather extensive studies are a collection of independently authored articles edited by Cain and Watts and a more recent analysis by Masters and Garfinkel.[11]

Age, sex, race, and marital status each affect worker response to net wage rates. One labor-supply study that includes labor elasticity estimates based on the above considerations is by Michael Boskin.[12] Boskin's study in the Cain and Watts collection includes a detailed section on elderly workers. He also considers cross-wage effects on labor supply where both husband and wife are working. In this area of study where the range of labor-supply elasticity estimates is so large, one must exercise personal judgment in identifying those studies that seem "reasonable." The elasticity estimates for studies most frequently cited and used tend to cluster in a significantly narrower range than for all such studies as a group. It is believed that Boskin's labor-supply elasticities are median or representative of the findings in these "more reliable" studies.

The Boskin study nevertheless has some specific data limitations or other characteristics in research design that necessitate adjustments for this article. Boskin's elderly workers are aged 60 and over. The net wage effects of changing wages on hours worked decrease with age. The presence of workers aged 60–64 in Boskin's elderly-worker estimates may tend to overstate labor responses by workers aged 65–69. Likewise, the presence of workers aged 70 and over may be a downward bias. No effort is made to adjust the Boskin estimates solely because his study population is aged 60 and over.

Moreover, the Boskin estimates of the substitution effects of elderly working wives must be reevaluated in the context of Masters and Garfinkel. The question is one of relative magnitudes. Boskin found the relative sensitivity be elderly working wives to changing net wage rates to be eight times that of their respective husbands. Masters and Garfinkel estimated the same response by elderly working wives to be two and one-half times that of their respective husbands. Boskin's estimates on this specific subgroup are not clear, although the present authors feel that use of this specific elasticity estimate would significantly distort and discredit the overall tax-revenue effects outcome. In this study, therefore, the estimated substitution effects of elderly working wives were recalculated using Boskin's methodology for consistency and Masters and Garfinkel's estimates of relative net changes for working spouses in their hours worked.[13]

Summarized below are the direct total labor-supply elasticities as used to estimate the tax impact on workers aged 65–69 and still active in the labor force, if the retirement test were eliminated. Other than the changes mentioned above, the elasticity estimates represent those that appear in Boskin,[14] with both races aggregated by the weights of black and white workers in the sample population.

Type of worker aged 65–69	Elasticity coefficient[1]		
	Total direct wage	Labor-supply income	Elasticity substitution
Unmarried men and women and working husbands	0.16	-0.02	0.25
Working wives..................	.40	-.05	.52

[1] Income elasticity is wage elasticity minus substitution elasticity. Income elasticity estimates reproduced here differ from the general rule because of unique specification used in regression analyses of changes in work effort.

The labor-supply wage elasticity (sometimes identified as the "net wage" elasticity) is the combination of the substitution effects and income effects when the net wage rate is changed. The wage-elasticity coefficient is an estimate of a relative change in hours of work effort in response to a specified relative change in net hourly wages. The wage-elasticity coefficient of .16 for unmarried men and women and for working husbands can be interpreted to mean that a doubling of the net wage rate will cause an average 16-percent increase in work effort for these individuals taken as a group.

It is assumed that the gross wage rates of workers would remain unaffected by the elimination of the retirement test. With this assumption the labor-supply elasticities can be converted to labor-response multipliers, with respect to the net wage effects alone. For two-worker couples, changes in work effort were jointly determined, thereby taking into account cross-elasticity effects of changes in the earnings of the principal worker (or in social security benefits) on the other spouse's work effort. The relevant labor-response multipliers and adjustments necessary to estimate net changes in work effort and tax liabilities for individuals and couples in each earnings class are also presented in the preceding tabulation.

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[11] Glen G. Cain and Harold W. Watts (editors), Income Maintenance and Labor Supply, Institute for Research on Poverty, 1973, and Stanley Masters and Irwin Garfinkel, Estimating the Labor Supply Effects of Income Maintenance Alternatives, Academic Press, 1977.

[12] Michael J. Boskin, "The Economics of the Labor Supply," in Glen G. Cain and Harold W. Watts (editors), Income Maintenance and Labor Supply, Institute for Research on Poverty, 1973.

[13] This integration of two separate studies with somewhat different population sample bases for purposes of adjusting only one labor-supply elasticity estimate is open to criticism. Masters and Garfinkel do not provide husband-wife cross-elasticity estimates (they assume such cross-substitution effects are relatively unimportant) and have other limitations. In the absence of other alternatives, it is believed that the recalculated Boskin estimate of working wives' substitution effect response is a reasonable approximation.

[14] Michael J. Boskin, op. cit.

One can see from table 1 that for 1978 the simulated work behavior of those persons aged 65–69 and presently working and of working spouses would generate $138.7 million of payroll tax receipts if 1982 payroll tax rates were employed. This amount represents 6.6 percent of the estimated $2.1 billion increased benefit-payout costs of eliminating the earnings test for persons aged 65 and over. The distribution of payroll tax revenues among OASI, DI, and HI trust funds are shown in table 2.

It should be recognized that this 6.6 percent reflects the conceptual approach most often used in previous studies. It does not include individual income-tax revenues that would accrue to the general fund of the Treasury. When the $191.3 million in income-tax revenues are included, the recoupment of benefit payments rises to 15.7 percent. In addition, not included are any tax revenues that would be generated from the group of persons who are currently retired but may choose to return to work or continue working.

Table 1.—Number of workers and change in earned income, income taxes, and OASDHI taxes resulting from elimination of retirement test, by earned income of workers aged 65–69, 1978

[Estimates in thousands]

Earned income	Number of workers[1]	Change in—		
		Earned income	Individual income taxes	OASDHI taxes[2]
Total	3,072,875	$1,035,358	$191,324	$138,736
Individual:				
$1–3,600	466,909	(4)	(4)	(4)
3,601–4,500	35,003	20,029	3,162	2,684
4,501–10,464	227,458	252,363	51,296	33,817
10,464 or more	128,210	-11,282	-3,679	-1,512
Married, principal wage earner with nonworking spouse:				
$1–3,600	427,643	(4)	(4)	(4)
3,601–4,500	42,087	24,231	2,028	3,246
4,501–14,482	302,114	432,633	79,614	57,973
14,482 or more	197,178	-26,029	-9,100	-3,488
Married, principal wage earner with working spouse:				
$1–3,600	149,252	(4)	(4)	(4)
3,601–4,500	22,208	12,364	1,187	1,656
4,501–10,464	130,461	155,043	37,322	20,776
10,464 or more	146,966	-19,400	-5,559	-2,600
Working spouse:[3]				
$1–3,600	329,024	(4)	(4)	(4)
3,601–4,500	62,124	33,502	3,222	4,489
4,501–10,464	263,536	184,078	44,234	24,666
10,464 or more	142,707	-22,172	-2,403	-2,971

[1] Includes all workers aged 65–69 classified as individuals or principal wage earners for income-tax purposes, and all working spouses of principal wage earners aged 65–69. All working spouses, regardless of age, could be affected by changes either in total household income or earnings of the principal wage earner.

[2] Based on 1982 combined employee-employer tax rate of 13.4 percent.

[3] Total number of working spouses equals total number of principal wage earners with working spouse when the 348,581 principal wage earners with zero earned income are included; for discussion, see section beginning in next column.

[4] No change in work behavior is assumed because the computer program, when applied to this specific group, uses an assignment of income that results in small income-tax increases even though earnings would decline.

Table 2.—Change in earned income and OASDHI taxes resulting from elimination of retirement test of retired workers aged 65–69, by type of worker, 1978

[Estimates in thousands]

Type of worker aged 65–69	Change in—				
	Earned income	OASDHI taxes			
		Total	OASI	DI	HI
Total	....	$678,614	$463,382	$83,561	$131,671
Current worker	$1,035,358	138,736	94,734	17,083	26,919
Retired worker—10 percent of selected workers	4,028,933	539,878	368,648	66,478	104,752
Percent of change in taxes[1]	....	13.4	9.15	1.65	2.6

[1] Based on 1982 combined employee-employer tax rates.

Impact of Test on Retired Workers

An estimated 5.7 million retired workers aged 65–69 received OASI benefits in 1978. One criticism of previous studies (other than Cagan[15]) on the impact of eliminating the retirement test is that possible reactions by these retired workers are ignored. The rationale in other studies for ignoring retired workers is based on the assumption that markets for labor services are reasonably competitive. If conditions were competitive, individuals could freely adjust the number of hours they work in response to changing wage rates. Retired workers alternatively could work up to the earnings ceiling without penalty. It follows from the basic assumption that these retired individuals prefer retirement to any work at all.

Alternatively, one can argue that many labor markets place serious institutional constraints on individuals in the adjustment of their hours of work. Some workers in their sixties may be confronted with "all or nothing" options. Opportunities for reasonable part-time employment for older workers may be scarce in some local labor markets. Workers approaching age 65 may have to choose between continuing current full-time employment for at least one more year, switching to an alternate occupation (perhaps at reduced hourly wages) close to full time, or stopping work completely.

Under these circumstances, the worker aged 65–69 may face the current forfeiture of most or all of social security benefits if he or she continues working full time. Worker attitudes toward retirement might change if the test were eliminated at age 65 (and maintained for covered workers aged 62–64).

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[15] Philip Cagan, op. cit.

Sparse information is available on retired workers' attitudes toward returning to work or on what the effect on workers' retirement plans would be if the retirement test were eliminated. Two recent studies based on the Social Security Administration Retirement History Study focused on the availability of retired persons for work and on determinants of retirement. Both studies indicate that few persons who retire would return to work if net wage rates were increased, but these studies are handicapped because respondents were interviewed about retirement or work while under the cloud of an existing retirement test. Dena Motley[16] in reporting on former workers aged 62–67 concludes that it appears that no more than 12 percent of such retirees would be very likely or even able to return to work. Joseph Quinn[17] in studying the determinants of early retirement noted that he could discern no evidence that an individual's wage rate or change in wage rate was an important determinant of retirement status. Quinn was cautious in interpreting this particular observation, however, as the insignificance of wage rates in the retirement decision may be a consequence of the earnings restriction itself. Other facets of the decision to retire as highlighted by Quinn also complement Motley's findings on the decision to return to work after retirement.

What about workers who have not yet retired? It is known that in 1975 a total of 484,000 workers aged 62, or 32.7 percent of all permanently insured workers aged 62, elected reduced early retirement benefits. More than 209,000 additional workers aged 63 and 123,000 workers aged 64 elected early retirement during that year. Cumulatively, 54.1 percent of permanently insured workers aged 64 were receiving early retirement benefits in 1975.[18]

Social Security Administration data from 1975 indicate that 69.5 percent of retired workers aged 65–69 and receiving OASI had elected early retirement benefits.[19] The vast majority of retired workers in this age class, therefore, have been out of the labor force 2–7 years. In the first year of impact of eliminating the retirement test, what percentage of these retired individuals would be able to find gainful full-time employment?

If the retirement test were eliminated, the policy action might affect early retirement decisions of individuals who are not yet aged 62. Some individuals who view the test as a barrier to work at age 65 may see it as a further impetus to an early retirement decision. (Early retirement is not effectively penalized under the Social Security Act, since the OASI benefits are actuarially adjusted.) Other individuals may increase their work effort in the years immediately before age 65 because they feel that the presence of the current test precludes further work after age 64. Again, no definitive basis exists for predicting the response of those potentially retiring early if the test were removed.

In summary, it can be expected that some retired workers aged 65–69 would reenter the labor market if the retirement test were eliminated. Some workers approaching a decision to retire early or to retire now could also be expected to continue their current employment at least through age 65. No previous studies were available that would provide any basis to estimate the relative magnitudes of individuals involved.

Estimates

The Treasury Department's statistically merged file of the SOI–SIE survey[20] provides estimates of all individuals and couples who file an income-tax return and of those who do not file a return. The sub-file for this study, therefore, approximates the total population aged 65–69. One difference is that the sub-file of the present study includes all couples where the principal wage earner is aged 65–69 although the spouse is not necessarily in this age bracket.

Each individual in the population must be counted either in individual (including all categories not joint) tax returns or joint tax returns, whether actually filed or constructed. A specification of "retired" is used for workers aged 65–69 with zero earned income in 1978.[21] The OASI benefits of the completely retired workers are reported in the SOI-SIE survey and statistically merged with Treasury records.

The principal wage earner on joint returns is identified as the retired individual with the greater OASI benefits. This individual in most instances is the husband. One cannot discern from the OASI benefits of the spouse (most likely the wife) whether he or she has previously worked or is drawing benefits as the wife or husband of a retired worker.[22] The spouse with zero earned income in 1978 is excluded from the base of retired workers who might return to the labor force. The basis for the estimates of retired workers returning to employment because of the elimination of the test is therefore restricted to all retired individuals and all joint-return retired principal wage earners.

This exclusion of spouses with zero earned income in

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[16] Dena K. Motley, "Availability of Retired Persons for Work: Findings From the Retirement History Study," **Social Security Bulletin**, April 1978.

[17] Joseph Quinn, "Microeconomic Determinants of Early Retirement," **Journal of Human Resources**, summer 1977.

[18] The number of individuals aged 64 with early retirement benefits in 1975 is the sum of early retirees (aged 62) in 1973, aged 63 in 1974, and aged 64 in 1975. Disabled workers are excluded from consideration.

[19] Two separate groups of retired workers in 1975 are viewed. The first group are OASI permanently insured workers aged 64 in 1975. Within this group, 54.1 percent were receiving early retirement benefits. The second group consists of permanently insured workers aged 65–69 in 1975 who are retired; 69.5 percent of this group were receiving early retirement benefits.

[20] Office of Tax Analysis, Department of the Treasury, **Statistics of Income; Bureau of the Census, Survey of Income and Education**, 1978.

[21] This is a most stringent specification of "retired" and may differ from alternative concepts of "retired" as used in some Social Security Administration tabulations.

[22] Spouses with positive 1978 earnings are discussed in the section on individuals still active in the labor force. The principal taxpayer in this study must be aged 65–69; spouses may be any age.

1978 does introduce some biases in estimation. The pool of retired workers is understated by the number of previously working spouses. The average earnings of workers who would return or remain in the labor force is biased upward by restricting the analysis to principal wage earners. Moreover, one spouse may be more likely to defer retirement if the other spouse is still active in the labor force.

Only retired workers who are qualified as permanently insured for OASI benefits are potentially affected by the presence of a retirement test. All retired individuals and retired principal wage earners who are not receiving OASI benefits therefore are also excluded from the pool of potential workers. Some of these workers are retired on government pensions. The noncovered retirees in 1978, however, tend to be dominated by low-wage and part-time workers. Exclusion of these retirees also further biases the potential worker pool toward individuals with higher average wages. In addition, for some retired workers presently receiving old-age benefits, the constructed average annual earnings when projected to 1978 would be less than the current $4,500 retirement earnings ceiling. For these low-wage retired workers, presumably, the decision to return to work is unaffected by the presence or elimination of the test, and they have been excluded from the tax effects estimates. These three considerations mutually reinforce the bias in the subfile of retired workers who potentially would continue work or return to work toward those workers with records of median or greater than median previous earnings. The opportunities for further employment also may be greater for this sub-group than for total retired workers.

An estimated 3 million retired workers are the basis for potential reentrants into the labor force if the retirement test is eliminated, as the figures that follow show.

Item	Estimates (In millions)
Retired workers:	
Permanently insured[1]	5.7
Individuals or principal wage earner[2]	3.8
Individuals or principal wage earners with constructed annual earnings above $4,500[3]	3.0

[1] Adjusted from Social Security Administration 1977 preliminary data.

[2] As classified in Treasury merged file. Excludes retired spouses.

[3] As classified in Treasury merged file. Excludes retired persons with low earnings.

Since these individuals are identified as "retired" because they showed no earned income in 1978, potential full-time earnings have to be constructed. The first step is to use annual OASI benefits received as the basis to determine "average monthly earnings" (AME) under the Social Security Act. The available AME for each retired worker aged 65–69 is an average of covered earnings for 14–19 years before retirement and therefore understates representative earnings for 1978. The AME, in turn, is adjusted upward by the annual percentage increase in average hourly earnings of workers covered by the social security program in each of the 9 years 1970–78. The 1978 average of the consequent constructed average earnings of all relevant retired workers (spouses with previous work history and constructed low-wage workers excluded) is $13,470. This amount can be compared with the Office of the Actuary estimate of $10,480 for the average annual earned income of workers currently contributing to the system in 1978 (with no distinction between part time and full time), based on average taxable earnings for the first quarter.

The income-tax returns of the sample individuals (individual and joint returns) were recalculated on the assumption that the individual or the primary household wage earner would realize his constructed earnings based on the adjusted AME if the retirement test were removed. The fact that the AME is calculated on OASI taxable earnings will understate the potential of high-wage workers whose previous earned incomes exceeded the taxable maximum. In the other direction, elderly individuals might not be able to continue work or resume work at wage rates as high as those enjoyed in the years immediately before retirement age.

Net tax-liability changes were calculated for all fully insured retired workers with constructed annual earnings above $4,500 who were classified as individuals (and all other returns not joint) and primary household wage earner on joint returns, whether or not such returns actually were filed. One-tenth of the net changes in income tax and payroll tax liabilities is then taken as representative of 10 percent of this select group of retired workers who defer retirement or return to work at annual earnings estimated from their adjusted AME. The taking of one-tenth of total tax-liability changes attributed to these retired entitled workers assumes that the 10 percent of retired workers who do return to work are representative of this group as a whole. This may not be the case. Dena Motley[23] noted that the maximum 12 percent of retirees who would be very likely or even able to return to work is biased toward the less-educated who had worked predominantly in blue-collar jobs with more modest earnings.

Table 3 summarizes the tax effects in eliminating the retirement test for permanently insured retired individuals and primary wage earners aged 65–69. The selection of 10 percent as an upper boundary—as the proportion of the select group of retired workers aged 65–69 (including retiring workers aged 65) who would continue full-time employment—is a personal judgment. Phillip Cagan[24] also based his estimates on the assumption that 10 percent of such retired workers continued or returned to employment full time. He notes, "As an illustration of what seems a large number but which is still conceivable, suppose 1/10 (of retired workers with no earnings) worked full-time. . . . Some of the panel find this far too high an estimate, but it does illustrate a range of possibilities for this large group for which no firm basis for an estimate exists."

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[23] Dena K. Motley, op. cit.

[24] Phillip Cagan, op. cit.

Table 3.—Number of workers, change in earned income, and increase in income taxes and OASDHI taxes resulting from elimination of retirement test, by income-tax filing status of retired worker aged 65–69, 1978

[Estimates in thousands]

Income-tax filing status	Number of workers[1]	Change in earned income	Increase in—	
			Individual income taxes	OASDHI taxes[2]
Total	299,000	$4,028,933	$786,450	$539,877
Individual[3]	148,000	1,294,485	211,130	173,461
Married principal wage earner	151,000	2,734,448	575,320	366,416

[1] Represents 10 percent of filed and nonfiled returns of retired workers with constructed annual earnings of above $4,500.

[2] Based on 1982 combined employee-employer tax rate of 13.4 percent.

[3] Includes filed and nonfiled returns of single persons, married persons filing separately and heads of households.

The present study stresses that the suggestion is not necessarily that all the workers in this group would come out of complete retirement and return to the labor force full time because of the elimination of the retirement test. Ten percent of the select group represents 299,000 workers aged 65–69 who otherwise would be in full retirement. It could be suggested that, with 1975 data used to determine relative weights, the interpretation could mean that about 25 percent (111,000) of the estimated 446,000 permanently insured workers who retired in their sixty-fifth year in 1978 would continue full time for one more year (with one-half, or 56,000, of these "extended" workers continuing for 2 more years) and that about 5 percent, or 132,000, of the remaining relevant permanently insured retired workers would return to the labor force full time, solely because of the elimination of the retirement test.

Since these figures are merely illustrative, other combinations are possible—those continuing work beyond age 65 and retired workers returning to the labor force—that will add to the total of 299,000. The above illustration does show, however, the importance of relative weights of different decisions that individuals within this age class must make: To continue current employment, to seek alternate employment, to retire, or to return to the labor force from retirement.

It is felt that the aggregate 10 percent of these retired workers aged 65–69 returning to or continuing work full time for at least one more year because of the elimination of the test is a reasonable upper boundary. Even in the absence of mandatory retirement provisions, elderly workers who now are retiring are constrained by many considerations from continuing employment or returning to the labor force. No basis for an alternate figure is apparent.

Conclusion

Table 4.—Increase in OASDHI taxes and individual income taxes resulting from elimination of retirement test, by type of worker aged 65–69, 1978

[Estimates in thousands]

Type of worker aged 65–69	Increase in—	
	OASDHI taxes[1]	Individual income taxes
Total	$678,613	$977,774
Current worker	138,736	191,324
Retired worker—10 percent of selected workers	539,877	786,450

[1] Based on 1982 combined employee-employer tax rate of 13.4 percent.

One can combine the net tax-revenue changes of current elderly workers returning or continuing in the labor force to obtain the total estimated tax-revenue effects in eliminating the retirement test. These estimates are contingent on the key assumptions used in selecting labor-response multipliers for current elderly workers—the assumption that 10 percent of retired workers aged 65–69 would either return to or continue in the labor force—and other judgments. Table 4 summarizes the net tax-revenue effects.

The Office of the Actuary estimates OASI benefit payouts in 1978 as $2.1 billion if the retirement test were eliminated for those aged 65–69. The $678.6 million increase in payroll taxes is calculated with a 1978 data base and 1982 OASDHI tax rates. The 1982 OASDHI tax rates are applied because of the known statutory increases in tax rates for 1982. [25]

The increase in payroll taxes, as calculated, represents a 32-percent offset to the estimated increase in social security payouts. Note that, although the OASI trust fund will bear all the additional cost benefit payments, only a portion of the estimated payroll taxes generated will flow into this fund. The balance will be distributed between the DI and HI trust funds as table 2 shows.

The estimate that increased payroll tax receipts would be 32 percent of increases in OASI benefits can be compared with estimates by Cagan. [26] Cagan noted that when one also considers retired workers, his calculated $830 million increase in payroll taxes (OASDI only) would be 33.2 percent of his $2.5 billion increase in OASI benefits payouts in 1975. He used the 1975 retirement test and OASDI tax rates. Since that time the test has been liberalized and is to be eliminated for beneficiaries aged 70–71 so that the number of workers affected by the test will be reduced and the estimated OASI benefit payout is down to $2.1 billion in 1978.

The estimated increase in individual income-tax receipts because of increased earned income is $977.8 million. If one were to add the estimated increase in payroll taxes and individual income taxes, the combined figure of $1,656 million for increased receipts in the "unified budget" represents about 79 percent of the increase in OASI benefit payments with the retirement test eliminated for workers aged 65–69. The $977.8 million in additional individual income-tax receipts presumably would be part of general funds, with the $678.9 million payroll tax receipts credited to the respective social security trust funds.

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[25] Given the decoupled system, increases in benefits and wages between 1978 and 1982 for the new cohort aged 65–69 should be roughly equal. The increase in the tax rate represents a "net" increase in the proportion of the increase in benefits offset by additional tax revenues.

[26] Philip Cagan, op. cit.

The response by retired workers to elimination of the retirement test is crucial to the tax revenue estimates. Removal of the test may affect the decision to retire as well as considerations to return to the labor force from retirement status. The potential pool of affected workers is a select subset of all retired workers aged 65–69 receiving OASI benefits in 1978. Note that an assumption of workers continuing or returning to the labor force equal to 10 percent of select current retired individuals aged 65–69 may be interpreted as 25 percent of workers currently retiring at age 65 and continuing full-time work for at least one more year, with one-half of these workers continuing for a second year, and 5 percent of the remaining retired workers returning to the labor force. Likewise, an assumption of 5 percent of select retired workers continuing or returning to work may be interpreted as 13 percent of retirees aged 65 continuing at least one more year, with one-half of these individuals maintaining employment a second year, and 2 percent of select retired workers returning to the labor force. Other allocations are possible. Three cases are presented in table 5 that represent alternative assumptions regarding select, current retired workers aged 65–69 who would continue in or return to the labor force if the retirement test were abolished.

Technical Note No. 1

The labor-supply multipliers applied to earnings after elimination of the retirement test are given below by earnings class, according to the amount of earned income of the principal taxpayer.

Earnings of principal taxpayer—$1–3,600

1. Unmarried. Workers in this class could have increased their earnings to $4,500 without losing benefits but chose not to. Consequently, no change in the hours worked by this group is expected after elimination of the test. (See relevant part of text for choice of $3,600 as class boundary.)

2. Married, spouse earnings—0
   - a. Principal taxpayer, no change.
   - b. Spouse, no change.

3. Married, working spouse. In this case, the response of the spouse to the increased wage rate, as well as that of the principal taxpayer, must be considered. Labor-supply multipliers for the spouse are specific to the prerepeal earnings of the spouse.

   a. Spouse earnings—$1–3,600. Since both members of the couple were not influenced by the retirement test, no changes in hours worked by either would be expected.

   b. Spouse earnings—$3,601–4,500. Since the principal taxpayer's earnings were not influenced by the retirement test, no change in his work behavior is assumed. If the spouse is aged 65–69, an earnings multiplier of 1.35 is chosen to apply to the spouse's current earnings. This figure represents a downward adjustment of the 1.4 multiplier applied to working spouses' earnings above the test ceiling. (See text tabulation on page 25.) The adjustment is made to reflect the fact that the portion of increased earnings below the $4,500 ceiling would not have been subject to the 50-percent marginal tax before elimination of the test.

   c. Spouse earnings—$4,501–10,464. No change is assumed in the principal taxpayer's tax effort, but the spouse realized a net wage effect of 1.4 times his or her original earnings.

   d. Spouse earnings—above $10,464. Assume no change in the principal taxpayer's work effort, but the spouse realized an income effect from the increase in family income. This negative income effect is calculated by multiplying .05 times the average annual benefit for an individual.

Earnings of Principal taxpayer—$3,601–4,500

1. Unmarried. Multiply earnings by 1.14. This multiplier reflects a downward adjustment of Boskin's 1.16 multiplier, which is applied to all principal wage earners earning more than the retirement test ceiling in effect before its elimination. The adjustment is made because earnings less than $4,500 before elimination are not subject to marginal tax.

Table 5.—Increase in OASDHI taxes and individual income taxes, increased OASI benefits, and percent of benefits recovered as a result of eliminating the retirement test, by alternative work behavior cases of retired workers aged 65–69, 1978

[Estimates in thousands]

Alternative work behavior cases of retired workers aged 65–69	OASDHI and individual income taxes			Increased OASI benefits	Percent of benefits recovered
	Total	Increase in—			
		OASDHI taxes	Individual income taxes		
Case 1: Only current workers who alter their work behavior	$330,060	$138,736	$191,324	$2,100,000	15.7
Case 2: Same as case 1 and 5 percent of current workers	993,224	408,675	584,549	2,100,000	47.3
Case 3: Same as case 1 and 10 percent of current workers[1]	1,656,387	678,613	977,774	2,100,000	78.9

[1] Individuals or principal wage earner with constructed annual earnings above $4,500.

2. Married, spouse earnings—0. Multiply current earnings by 1.14 as in item 1 above.

3. Married, working spouse. Where both persons are working and at least one is earning beyond $3,600 and therefore sensitive to the retirement test, both the positive substitution effect and the negative income effect must be accounted for as well as their interaction in producing the joint family income. Again, the spouse response will vary depending on the level of earnings.

  a. Spouse earnings—$1-3,600. Here one would expect the spouse to experience only an income effect in response to the principal taxpayer's new level of earnings since he or she probably was not choosing the level of work effort based on the retirement test. Therefore, to determine new family earnings, multiply the principal taxpayer's earnings by 1.14, add the earnings of the spouse, and subtract from that .05 times the change in the principal taxpayer's earnings.

  b. Spouse earnings—$3,601–4,500. In this case the spouse is likely to be choosing a level of work effort in response to the retirement test. For that reason, the same multiplier (1.35) for spouses aged 65–69 as was used for this class of spouse of the principal taxpayer with earnings of $1–3,600 is chosen to increase spouse earnings. The principal taxpayer's earnings are multiplied by 1.14, and the combined earnings and social security benefits of worker and spouse aged 65–69 are then reduced by .05 times the change in principal taxpayer earnings to account for the income effect.

  c. Spouse earnings—$4,501-10,464. The same multipliers are used as in the item immediately above, except that 1.4 instead of 1.35 is used because all previous spouse earnings were subject to the tax.

  d. Spouse earnings—above $10,464. Principal taxpayer earnings are multiplied by 1.14. The spouse realizes a double income effect as a response to increased family income from previously withheld benefits as well as from the increase in earnings of the principal taxpayer generated by his increased work effort.

Earnings of principal taxpayer—$4,501–10,464 ($14,482)

1. Unmarried. Multiply current principal taxpayer earnings by 1.16 ($10,464 relevant maximum).

2. Married spouse earnings—0. Multiply current principal taxpayer earnings by 1.16 ($14,482 relevant maximum).

3. Married, working spouse ($10,464 relevant maximum).

  a. Spouse earnings—$1-3,600. Same as under principal taxpayer with earnings of $3,601–4,500 at the similar level of spouse earnings, except principal taxpayer earnings multiplied by 1.16 instead of 1.14.

  b. Spouse earnings—$3,601–4,500. Same as under principal taxpayer with earnings of $3,601–4,500 at the similar level of spouse earnings, except for modification of principal taxpayer earnings at this level.

  c. Spouse earnings—$4,501-10,464. Same as under principal taxpayer with earnings of $3,601–4,500 at the similar level of spouse earnings, except for modification at this level.

  d. Spouse earnings—above $10,464. Same as under principal taxpayer with earnings of $3,601–4,500 at the similar level of spouse earnings, except for modification at this level.

Principal taxpayer earnings greater than $10,464 ($14,482)

1. Unmarried ($10,464 relevant minimum). At this level of earnings one expects the income effect to dominate and work effort to be reduced slightly. To obtain new earnings the change in income due to receipt of previously withheld benefits (average annual benefits for 1978) was multiplied by .02 and subtracted from current earnings.

2. Married, spouse earnings—0 ($14,482 relevant minimum). Multiply the change in income due to the receipt of previously withheld family income by .02 and subtract from current earnings.

3. Married, working spouse ($10,464 relevant minimum).

  a. Spouse earnings—$1-3,600. The principal taxpayer experiences the same income effect as in the item immediately above. The spouse responds by reducing his or her earnings by .05 times the net change in principal taxpayer income as stated in the preceding item.

  b. Spouse earnings—$3,601–4,500. The principal taxpayer reduces his or her work effort as for married taxpayer with zero spouse earnings. The total effect on the spouse aged 65–69 is found by multiplying his or her earnings by 1.35 and then subtracting .05 times the net change in principal taxpayer income. For spouses under age 65, earnings are reduced by .05 times the change in principal taxpayer income.

  c. Spouse earnings—$4,501-10,464. The same as preceding item, except for upward adjustment of 1.35 to 1.4.

  d. Spouse earnings—above $10,464. The principal taxpayer experiences an income effect, and the spouse responds by reducing his or her earnings by .05 times the change in combined family incomes.

Technical Note No. 2 *

The estimates presented here are based on an extract of the 1978 MATCH sample of the Department of the Treasury. The extract covers the population of all tax units, both filing and nonfiling, in which at least one individual in the tax unit was in the age interval 65–69. The 1978 MATCH sample is constructed from essentially two data sources:

(1) The 1975 Statistics of Income (SOI), a stratified sample of more than 200,000 unaudited tax-return forms 1040 and 1040A filed by U. S. citizens and residents during calendar year 1976 for calendar year 1975; [27] and

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* Prepared by Roy A. Wyscarver, Office of Tax Analysis, Office of the Secretary of the Treasury.

[27] For a more detailed description of this sample and the sampling procedures, see **Internal Revenue Service, Statistics of Income—1975 Individual Income Tax Returns**, Department of the Treasury, 1978, pages 180–181.

(2) The 1975 Survey of Income and Education (SIE), a sample survey containing data on demographics, housing, health, money and noncash income, and assets for 151,195 U. S. households. [28]

Neither of these data sources, however, is used in its original form.

Sample Design

The actual methodology used to produce the 1978 MATCH sample is still in the development stage, and the documentation that exists covers several hundred pages. The sample design is described briefly here.

Beginning with the 1975 SOI, the Office of Tax Analysis draws a 50,000 subsample of annual tax returns, stratifying in order to optimize the estimate of taxes paid. This sample is edited and corrected to generate a production 1975 SOI subsample. To the tax-return data on each record is appended exact age, race, and sex through an identifier match with social security earnings records.

The 1975 SIE sample is also subsampled to yield 50,829 households. Each household in the 50,829 subsample is disaggregated into tax units, thus producing a 1975 SIE subsample of 76,692 tax units. The 1975 SIE subsample of tax units is then further divided into a set of filers (60,094 tax units) and nonfilers (16,598 tax units).

Since the 1975 SOI subsample and the set of filers from the 1975 SIE subsample are both on a tax-unit basis, these files could be "matched" if an attribute existed on each file that would permit an "exact match." No such attribute exists. Common attributes on the two samples can be used to perform an attribute match, given some criterion for determining which "match" in the set of all feasible matches is the "best" match.

This determination is made by constructing a *distance function* that yields a weighted measure of the information dissimilarity between an SOI tax return and a filing SIE tax unit. In other words, the distance function assesses a penalty that varies directly with the degree of mismatching.

Given the distance function, [29] the task of matching the two samples can be formulated as a classical transportation problem where the 1975 SOI subsample represents the "source" and the set of filers in the 1975 SIE subsample represents the "sink," and the distance function is to be minimized.

The size of this problem—50,000 nodes and up to 62 million admissible arcs—is extremely large and required the use of an extended transportation system algorithm [30] that matches tax returns with SIE tax units. The algorithm is designed so that a tax return in the 1975 SOI subsample may be "split" or matched with more than one tax unit in the set of filers in the 1975 SIE subsample. [31] Since it is required that the adjusted weights sum to the original weights, however, the statistical properties of both samples are maintained while achieving the lowest possible information dissimilarity, as measured by the distance function.

The actual output from the transportation algorithm is a set of linkages that identifies the tax filing SIE records in the 1975 SIE subsample of filers that will be "matched" with each tax return in the 1975 SOI subsample. These linkages are employed to append selected data from the appropriate tax filing SIE record in the 1978 SIE sample (as aged by the MATH Model [32]) to each tax record in the 1975 SOI subsample. Thus, each filing tax-unit record contains 1975 law-and-levels SOI data and extrapolated 1978 law-and-levels SIE data.

Once the 1978 SIE has been linked with the 1975 SOI, a process known as the "post merge" is performed. In the "post merge," each 1975 SIE tax unit that was a member of the set of nonfilers is retrieved from the 1978 SIE sample. Since none of these SIE tax units was matched with a SOI tax return, a synthetic 1978 SOI tax "return" is created from the available SIE data. Thus, each nonfiling tax unit contains a synthetic SOI tax return and selected SIE data. The nonfiling tax units are merged with filing tax units to produce a sample of 126,663 tax units.

At this point, the full MATCH sample still contains 1975 law-and-levels SOI data for all of the tax-filing population. In the final adjustment, the 1975 law-and-levels SOI data is extrapolated to 1978 law and levels by employing the Department of the Treasury's personal individual income-tax model extrapolation.

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[28] For a more detailed description of this sample, see Data Access Descriptions—Microdata from the Survey of Income and Education (No. 42), Bureau of the Census, January 1978.

[29] The distance function used 13 common attributes: Age, race, sex, family size, gross income, wages and salaries, self-employment nonfarm income, self-employment farm income, property income, wife's wages and salaries, State code, schedule code, and original weight.

[30] Developed for Office of Tax Analysis by Analysis, Research and Computation, Incorporated, Austin, Texas.

[31] "Splitting" a tax-return record means that a tax-return record may be linked as many times as necessary as long as the weights on the linked tax returns sum to the original weight. For example, a tax return with a weight of 1,000 may be split into three records with weights of 100, 200, and 700, or any other combination whose sum equals 1,000. The number of times a tax return is split and the apportioning of the original weight among the split returns depends on the SIE tax units that the tax return is matched with and the weight of those SIE tax units.

[32] The MATH (Micro Analysis of Transfer Households) Model developed by Mathematica Policy Research is a software package used to simulate the impact of tax and transfer programs by aggregating over household level data. Aging or extrapolating a data file entails reweighting the records and adjusting each record's income and deductions to make the sample representative of the personal income-tax-paying population in a year other than the year for which the observations actually relate.

Attachments to the prepared statement of Jack Ossofsky

ATTACHMENT A

EXCERPT FROM PUBLIC POLICY STATEMENTS OF THE NATIONAL COUNCIL ON THE AGING

SOCIAL SECURITY

Social Security has proven, over four decades, to be a highly effective method of income maintenance. Without social security, about twelve million people who are above the poverty line would be counted as poor. For practically everyone, the expectation of social security benefits is the foundation of retirement security, and security for the family in the event of the worker's long-term disability or death. According to the NCOA/Lou Harris study, The Myth and Reality of Aging in America, social security benefits were a current source of income to 89 percent of those over age 65, and the largest source of income to 58 percent.

NCOA believes that changes should be made (a) in the method by which the social security program is financed, (b) to improve in several ways the protection the program affords, especially for women, (c) to remedy several gaps and inadequacies in the program, and (d) to better insulate the program against political pressures.

Financing.—Questions have been raised in many quarters about the adequacy of social security's financing provisions, especially in light of recent and current economic factors and in light of demographic and other projections into the long-range future. Contrary to much popular belief, there is no danger that social security will be unable to pay benefits as due. The increases in financing that may be required over what is provided by present law for meeting both short-term and long-term care costs are relatively small. It is inconceivable that, given the stake that practically the whole country has in social security at any given time, any Congress will allow the system to become unable to pay benefits as due. For example, employee tax rates in say, the 25-year period beginning 25 years hence may—of the system continued to be financed solely through payroll taxes—need to be higher by about one-half of one percent of payroll than the rate (6.2 percent) scheduled in present law. But the social security expenditures for that period would represent only a little over five percent of gross national product, or a little over one-quarter of one percent of GNP more than is represented by expenditures for 1981. Since there will be substantially fewer children than today, the higher tax rates would be paid by a population that spends substantially less (in constant dollars) than is spent today for the support and education of children. Total dependency ratio (population 65 and over plus population aged 20–64) can be expected to be lower during the next 35 years that it is in 1980, and lower during the next 75 years than it was in 1970. In addition, the real wages of those workers are likely to be approaching double of those of 1980. Financing of social security, even if based solely on payroll taxes, should actually be less burdensome in the early decades of the 21st century than it is now.

NCOA believes, however, that the system should not continue to be financed solely through those taxes. The cost of weighting benefits in favor of low earners, and of other social elements of the program, should be met through graduated taxes, via general revenues, and not entirely through a flat-rate tax on payrolls.

With a contribution to the program from general revenues (such as is provided in the great majority of social insurance programs in other countries) contribution rates in the 21st century will probably not need to be raised much, if at all, above the 1981 rate, even though costs are increased by reason of benefit changes such as we are recommending.

Women.—In recent years, social security has been the object of increasing scrutiny with regard to how it affects women. In part, this scrutiny reflects changes that have occurred in our society: the extent to which women participate in the labor force; the impact of employment discrimination and other factors (including child bearing) that have restricted women's average earnings and, therefore, social security benefits; increases in divorce rates, leaving more women with less than adequate social security protection, growing recognition of the economic value of a woman's work in the home; and growing dissatisfaction with eligibility for benefits that is based on a dependency status.[1] While social security is surely not responsible for these societal shifts, NCOA believes that a number of changes can and should be made to improve the way the program works for women.

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[1] Legislation and court decisions have resulted in the elimination of all significant gender-based distinctions in social security benefit categories except one: men who reached retirement before 1975 have their average earnings, and also insured status, figured over the period up to their attainment of age 65 rather than on the more liberal basis of age 62, as do women.

Independent system.—Social security is not just a tax program or a benefit program; it is a system of social insurance. Contributions are paid by employees, and by employers in their behalf, and benefits are paid that reflect those contributions. Yet recent critics have included social security trust fund expenditures in calculations used to support assertions that older people are getting more than their "fair share" of the federal budget. This distortion has hampered efforts to improve other aspects of the lives of older Americans.

NCOA makes the following specific recommendations:

Part of the cost of the social security system, as much as one-third in the long run, should be met from general revenues, that is, primarily from graduated taxes that extend to upper levels of income and are derived from sources beyond wages, salaries, and self-employment income.

Social security primary benefits should be increased by one-eighth and spouses' benefits, except in the case of a divorced spouse, should be reduced by one-third, so that the combined benefit for a one-earner couple comes out to one and one-half times the present primary benefit. Benefits would thus be increased for, among others, the two classes of beneficiaries—single women and widows—who generally get the lowest benefits and are the least well off. Also, benefits would be significantly incresed for two-earner, as against one-earner couples. A divorced spouse would receive 45 percent of the increased primary benefit, or about 50 percent (as now) of the present primary benefit.

Provisions of current law liberalizing the earnings or "retirement" test should be retained.

Proposals to deliberalize social security by raising the age for full retirement benefits should be rejected. Such a change would break an implicit promise to social security contributors, would cause hardships to those unable to work after 65 or unable to get a job, and is wholly unnecessary for purposes of making the program financially sound.

Persons regularly covered under social security, even at minimum wages, for most of their work lives should be assured of benefits at least equalling the official poverty income level.

The benefit formula should be adjusted so that for each added dollar of contributions paid the worker who has high earnings can expect, as can all other workers, at least an additional dollar of benefits.

Additional "drop out" years should be allowed, in figuring the benefits of persons who remain out of the work force while they have young children in their care.

A special benefit should be paid for one year to assist widows in entering or reentering the work force.

Benefits should be paid to disabled spouses of retired or disabled workers, and benefits to disabled widows or widowers should be paid at any age and without reduction because of age.

The present 5-month waiting period for disability benefits should be reduced to 3 months.

Disability benefits should begin after the waiting period, without any requirement that the disability be expected to last 12 months or until the worker's death.

For workers age 55 and over, disability should be defined in terms of inability to perform one's usual occupation rather than, as at present, inability to do any substantial gainful work. The revised definition would be similar to that used in present law in the case of blindness.

Cost-of-living adjustments in benefits should be made, when prices rise rapidly, every six months, instead of, as at present, on an annual basis.

Serious consideration should be given to changes in the system which recognize that marriage represents an economic partnership. The so-called "earnings sharing" concept is deserving of special consideration. Care must be taken, however, not to endanger present dependency-based benefits unless some better alternative is put into place.

The Social Security Administration should be established as an independent agency, and the transactions of the social security trust funds separated from the unified federal budget.

Social security benefits should be adjusted, not only for changes in the cost of living, but also to reflect increases in the standard of living in the country.

ATTACHMENT B

Journal of Gerontology
1978, Vol 33, No 2, 262-269

Liberalizing the Social Security Retirement Test

Who Would Receive the Increased Pension Benefits?

James H. Schulz, PhD

The article examines the distributional impact of liberalizing the social security retirement test. The results of simulations that explore ten liberalization alternatives are presented. The distribution of pension benefit gains from liberalization of the test are determined for the aged who were affected by the test in 1972. The relative costs of various liberalization alternatives are compared with complete abolition of the test.

ONE of the most controversial aspects of the American social security system has been the retirement test. A retirement test makes payment of a pension dependent upon partial or complete nonparticipation in specified areas of employment. Since 1939, the retirement test has been changed by new legislation a total of 13 times.

The major change in the retirement test occurred as a result of amendments passed in 1972. The amount of annual earnings exempted was liberalized to $2,100 (effective 1973). The reduction of benefits dollar for dollar at the $2,880 level (i.e., a 100% tax rate) was eliminated, and a reduction of pensions equal to 50% of earnings extended to *all* earnings above $2,100 (not just to earnings between $1,681 and $2,880 under the prior test). In addition, the general indexing provisions embodied in the 1972 amendments included the retirement test. The earnings exemption was legislated to be adjusted annually by a wage index (average taxable social security earnings). Thus, by 1977 the exempt amount had reached $3,000 by this automatic adjustment process and an *ad hoc* increase in 1973.

In December, 1977, the most recent change was legislated. The new provision liberalizes the test only for those age 65 or older. The exempt amount is scheduled to rise (apart from inflation adjustments) from $4,000 in 1978 to $6,000 in 1982. In addition the current exemption of *all* earnings for those age 72 or older will be changed in 1982 to apply to persons over age 69.

Much of the debate over the retirement test has been focused on the two extreme policy alternatives: no test versus a very severe test. Critics argue for abolition of the test, while supporters argue the need for a test and usually support a test similar to the one actually existing at the time. We argue in this paper, however, that a more useful way to frame the issue is to pose the question: how much liberalization of the current retirement test should there be? The answers "no liberalization" and "complete elimination" of the test thus become polar responses, with a wide range of less extreme alternatives open for consideration.

Consideration of the alternatives *between* the extremes has received little systematic attention in both the political debates and the social literature. In another article (Schulz, 1977) I have reviewed the prior research and summarized the arguments that have been made for and against the test. To us there is merit in many of the arguments made both by those who wish to abolish the test and those who favor a stringent test. And this, therefore, suggests to us that it is appropriate to focus attention on alternatives other than the two extremes.

Liberalization of the retirement test would increase the incomes of older persons in two ways. Social security recipients who are not working or who are working up to the no

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[1] Funds for this research were provided by the NRTA/AARP Andrus Foundation. Mr. Manfred Peschke contributed to the programming and project design efforts. The comments and suggestions of Thomas Borzilleri, Barbara Lingg, Lucy Mallan, Robert Meyers, David Podoff, and Charles Schottland on a draft of this paper are appreciated. Special thanks go to Frederick Scheuren of the Social Security Administration for expediting the availability of the data necessary for this study.

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penalty earnings ceiling would be able (encouraged) to seek work that would provide additional *earnings* income. Social security recipients working beyond the ceiling (and receiving *reduced* benefits) and nonrecipients receiving no benefits because their earnings are too high would receive (in many cases) *benefits* previously unpaid.

The research undertaken focused on the latter group and their increased *benefits*. Supporters of a stringent test often argue that most of the people subject to the retirement test do not "need" the additional money received from liberalization, that they all have a "significant" amount of earnings, and that many who work full-time have *substantial* earnings. The results of this study show, however, that significant liberalization of the test could occur *without* the additional pension benefits going primarily to the higher income aged.

Alternatives to the Current Retirement Test

There are five major components of the retirement test that can be changed:

(1) The amount of earnings exempted from tax — $4,000 beginning January 1, 1978.
(2) The tax rate on earnings over the exempted level — currently 50%.
(3) An age exemption from the test — currently age 72 (age 70 in 1982).
(4) The accounting period — currently both a monthly and a yearly test.
(5) The apportionment treatment of spouses; currently a worker's earnings may also reduce a spouse's benefit, while a spouse's earnings cannot reduce a worker's benefit.

In the study reported on here, only changes in the first two components — the exempt amount and the tax rate — were considered. Three different "types" of retirement tests were simulated using earnings data for the aged population in 1972. First, the impact of various increases in the exemption amount were studied. Second, graduated retirement test tax rates (similar to a recommendation in the 1975 report of the Social Security Advisory Council) were investigated. And, finally, a combined income test similar to an earlier proposal by the author (Schulz, 1971) was simulated.

To carry out these simulations, a sample of the aged population in 1973 was used. The data file was the first version of the "CPS-SER" file. This data file consists of selected items from the 1973 Current Population Survey (CPS) that have been linked with an extract of social security information taken chiefly from the Social Security Administration's Computerized Summary Earnings Record (SER) system (U.S. Social Security Administration, 1975). From this file persons age 62 or older were selected; this sample served as the basic data for the various simulations. Earnings and social security information were available on the tape (from the CPS Survey) for the prior year, 1972. The basic procedure, therefore, was to:

(1) Determine which survey units were subject to the retirement test in 1972, based on the tape information regarding their insured status, marital status, and earnings.
(2) Determine the year of initial social security entitlement by comparing benefits reported with benefits estimated for entitlement at various ages (62 to 65) using the social security earnings history information on the data tape.
(3) Calculate the new tax, if any, that would result from each alternative retirement test.
(4) Apply the new tax to the estimated social security benefit to determine what benefit would be received under the alternative retirement tests.

The need to estimate the age of initial entitlement (step 2 above) was made necessary because this information was not provided on the data tape. A benefit was estimated, therefore, for each possible age of retirement between age 62 and 65. These estimates were then compared to the reported benefit on the tape and the best match selected. Methodologically the most difficult task was to identify persons with reported benefits who had begun receiving these benefits *during* 1972. Most of these people were *not* subject to the retirement test because they stopped receiving earnings upon entitlement. Thus, it was important to identify such persons so that they would not be included in the analysis group. A computer program executing a decision-making tree was developed to identify these "newly retired" persons — comparing *actual* reported benefits with *estimated* benefits that assumed entitlement before 1972.

Excluded from the analysis were persons not subject to the test: persons age 73 or older, persons not "fully insured," and persons with either no earnings or earnings *under* the 1972 retirement test ceiling. Spouses of "relevant" workers were retained even if they fell into one of the above three categories. Also excluded, because of methodological difficulty, were widows.

The analysis assumed no change in work effort as a result of changing the test, since no good empirical basis for predicting these changes was available. It is important to remember, therefore, that the study does not address the important issue of the extent to which work effort is reduced by the test and the extent to which older people would benefit psychologically and economically from more work.

In the face of chronic and sometimes severe unemployment in this country, the retirement test, like the social security program in general, was designed to encourage the retirement of older workers. The hope was (and is) that in the absence of full employment, job opportunities for younger workers would (will) be created. And, in fact, a recent study by Boskin (1977), using longitudinal data on 131 households with heads initially age 61 through 65, indicates that a strong work disincentive arises from the retirement test.

While the work incentive issue is important, the data used limit our focus to the other issue. We investigate *the distribution of social security increases* resulting from a change in the retirement test and determine who would gain new or additional pension benefits.

Finally, no information was available on monthly earnings. Therefore, it was not possible to apply the *monthly* retirement test (which permits individuals to receive benefits in any month where wages do not exceed, in 1977, $250) to individuals who worked during the analysis year.

Given the estimating procedures described above, an analysis of the 1972 earnings of aged persons age 62 and over found that there were about 2.1 million workers with benefits affected by the retirement test that year. In addition, it was estimated that 0.4 million spouses were similarly affected. This affected count includes both those who had their social security benefits reduced and those who had not even applied for benefits because their earnings were so high that the benefit would have been completely wiped out by the test.

Two studies by Lingg (1975 and 1977) provide a means of checking the reasonableness of our estimate for 1972 and hence provide a rough check on how well the CPS sample and our estimating procedures identified workers affected by the test. Lingg reports that there were 1.5 million worker beneficiaries in 1971 and about 1.4 million worker beneficiaries in 1973 affected by the test. This estimate, however, excludes a large number of workers age 62 to 64 (and a small number age 65 and over) who did not file for benefits. Using CPS data on the distribution of aged earnings provided by Thompson (1974) and social security coverage data, we estimate that there were roughly 1.0 million social security eligible workers age 62 to 64 with earnings over $5,000 in 1971. Thus, our 1972 estimate of 2.1 million is 400,000 workers lower than the estimate for 1971 (1.5 + 1.0 million), indicating that our sample underestimates those affected.

Our estimates show that while the majority of those affected by the retirement test had substantial earnings, a not inconsequential number did not. About 13% of the affected units (with and without spouses) had "family" money *income* (from all sources) that was less

Table 1. Simulated Liberalization Alternatives.

Alternative Number	Type of Test	Earnings Exemption Level	Tax Rate (%)
1968-1972 Retirement Test Regulations	three-tier: 100%	after $1,680 after $2,880	50 100
Alternative 1	two-tier	after $1,680	50
Alternative 2	two-tier	after $3,360	50
Alternative 3	two-tier	after $5,040	50
Alternative 4	two-tier	after $6,720	50
Alternative 5	three-tier	after $1,680 after $3,360	33 50
Alternative 6	three-tier	after $1,680 after $5,040	33 50
Alternative 7	three-tier	after $3,360 after $5,040	33 50
Alternative 8	three-tier	after $3,360 after $6,720	33 50
Alternative 9	combined income	if social security + earnings:	
		≤ $4,968	0
		$4,969 — $7,692	33
		$7,693 or more	50
Alternative 10	No Test	unlimited	—

than $5,000 and about 45% of the affected units had incomes less than $10,000.

Who Gains from Liberalization?

Ten different liberalization plans were simulated; these are summarized in Table 1. For every retirement test alternative, new benefit determinations were made for each eligible worker (and his or her spouse, if appropriate) affected by the retirement test law as it actually existed in 1972. With each liberalization alternative a certain number of affected persons would be eligible for larger social security benefits.

One of the most interesting and useful criterion for assessing who benefits from each type of liberalization is to show *what proportion of the additional benefits paid out are received by various income groups*. Total *family* money income, as opposed to *individual* income, was chosen as a more meaningful indicator of the aged units' economic status.

There are an almost unlimited number of ways to liberalize the retirement test by changing the combination of the exemption level(s) and/or the tax rate. The ten alternatives investigated in the study can be grouped into three types. Table 2 shows who benefits from a two-tier type that is similar to the current retirement test (with one unchanging tax rate on earnings above the exemption level). This type differs from the type that actually existed in 1972, which taxed earnings from $1680 to $2880 at 50% and earnings above $2880 at 100%.

Alternative 1 liberalizes the test by eliminating the 100% tax rate without raising the exemption amount. The other two-tier types also use a 50% tax but raise the earnings exemption level by multiples of the basic $1680 amount. Table 2 shows the distribution of *additional* benefits that would be paid out for the four two-tier alternatives. Also shown, for comparison purposes, is the distribution that would result if the retirement test were eliminated.

Under alternatives 1, 2, and 3, Table 2 shows that about two-thirds of the additional benefits paid out in larger pensions to certain persons affected by the test would go to survey units with family incomes in 1972 that were less than $10,000. A relatively high earnings exemption of $6,720 (alternative 4) results in slightly over half the additional benefits going to survey units with family income under $10,000. For comparison purposes, the median income in 1972 was $12,523 for all United States families and $4,150 for unrelated individuals.

In striking contrast is the distribution of benefits when there is no retirement test. As shown in Table 2 (alternative 10), only 38% of the extra benefits would go to families at the less than $10,000 family income level (substantially lower than the other alternatives). Most significant is the two to threefold increase in the share of benefits going to aged families with incomes of $20,000 or more. This high income group represented only about 13% of the total aged population affected by the test, but with the abolition of the test would receive about 17% of the total increase in benefits. And affected persons with family income over $10,000 would realize more than half the total gain!

Table 2. Distribution of Additional Benefits Paid by Two-Tier Alternatives, by 1972 Family Income.

		Alternative and Exemption Amount				
Family Income	Families[a]	1 $1,680	2 $3,360	3 $5,040	4 $6,720	10 Unlimited
Less than $5,000	13	22	21	22	11	7
$5,000 – 9,999	32	44	43	44	42	31
$10,000 – 19,999	33	21	23	21	29	37
$20,000 or more	6	5	5	6	9	17
Unknown	16	7	8	7	8	8
Total %[b]	100	100	100	100	100	100

[a] % of "families affected by retirement test" (see text) in each family income category.

[b] May not sum to 100% due rounding.

Source: Simulations.

Table 3. Distribution of Additional Benefits Paid by Three-Tier Alternatives, by 1972 Family Income.

			Alternative			
			5	6	7	8
		Exemption Level:	$1,680 $3,360	$1,680 $5,040	$3,360 $5,040	$3,360 $6,720
Family Income	Families[a]	Tax:	33% 50%	33% 50%	33% 50%	33% 50%
Less than $5,000	13		23	20	18	16
$5,000 — 7,499	18		26	27	28	27
$7,500 — 9,999	14		17	17	17	18
$10,000 — 19,999	33		22	22	23	24
$20,000 or more	6		6	6	6	7
Unknown	16		8	8	8	8
Total %[b]			100	100	100	100

[a] % of "families affected by retirement test" (see text) in each family income category.
[b] May not sum to 100% due rounding
Source: Simulations

Table 3 presents the results for a different type of retirement test — one that has two tax rates. These three-tier tests have an upper tax rate at 50%, instead of the 100% upper rate which was in effect over the 1961-1972 period. The Advisory Council on Social Security recommended in 1975 such a three-tiered test with a 33.3% tax rate above the annual exemption level and a 50% rate on all earnings in excess of twice the exempt amount. Alternatives 5, 6, 7, and 8 are variants of the Advisory Council recommendation. However, the lowest exemption level ($1680 in alternatives 5 and 6) is lower than the current exemption levels, since the earnings of the survey population were typically much lower in 1972.

The distribution of gains under the three-tier tests (Table 3) is very similar to those for the two-tier tests (Table 2). Some differences do appear, however, at the higher exemption levels. A tax rate of 50% on earnings above $5,049 (alternative 3) gives a greater proportion of the benefits to very low income families (66%) than a three-tier test where an additional 33% tax a year is inserted on earnings between a $3,360 exemption level and $5,040 (alternative 7). But if the upper exemption level (alternative 4) and the upper tax level (alternative 8) are raised to $6,720, the opposite occurs. The share gained by low income families is 53% (alternative 4) versus 61% (alternative 8). Also, at the highest exemption levels, the share of those with incomes above $10,000 is lower (31%) for the three-tiered test (alternative 8) than for alternative 4 (38%).

A different type of test is illustrated by alternative 9. The exemption level for this test is for combined earnings *and social security pension income*. This exemption level was combined with two tax rates in three tiers (33% above $4,968 and 50% above $7,693). The $4,968 and $7,693 amounts were chosen based on the Bureau of Labor Statistics' estimates of a "modest but adequate" budget for an older couple (Gedney, 1973). The published 1972 "intermediate" and "higher" budget levels were used to specify the exemption and upper tax level for alternative 9.

Table 4 shows the distribution of benefits arising from a liberalization of the retirement test using a "combined income" test. For comparison purposes the distributions for alternatives 8 and 4 are also reproduced.

The combined income alternative generally results in a lower proportion of the benefit gains going to those below $5,000 family income. Of the ten alternatives examined, only alternatives 4 and 10 (no test) have a lower proportion going to the lowest group. Moreover, at the upper end, only alternative 10 (no test) has a higher proportion going to those with family incomes of $20,000 or more.

The two alternatives with distributions approximating the combined income alternative are shown in Table 4. Both are the most liberal plans examined of their respective types. However, over the entire income range

Table 4. Distribution of Additional Benefits Paid by a Combined "Social Security Plus Earnings" Test, by 1972 Family Income.

		Alternative		
		9	8	4
Family Income	Families[a]	Combined Income	$3,360 $6,720	$6,720
Less than $5,000	13	15	16	11
$5,000 — 9,999	32	38	45	42
$10,000 — 19,999	33	32	24	29
$20,000 or more	6	9	7	9
Unknown	16	8	8	8
Total %[b]		100	100	100

[a] % of "families affected by retirement test" (see text) in each family income category.
[b] May not sum to 100% due rounding.
Source: Simulations.

Table 5. Costs of Alternative Tests Relative to Actual Benefits Paid to "Affected Persons"[a] in 1972.

Alternative	Exemption — Tax	Ratio[b]
1	$1,680 50%	1.22
2	$3,360 50%	1.93
3	$5,040 50%	2.78
4	$6,720 50%	3.66
5	$1,680 33% $3,360 50%	1.42
6	$1,680 33% $5,040 50%	1.57
7	$3,360 33% $5,040 33%	2.16
8	$3,360 33% $6,720 50%	2.39
9	$4,960[c] 33% $7,693 50%	2.28
10	no test	3.84

[a] "Affected persons" are persons eligible for social security retirement benefits who have these benefits reduced because of the retirement test or who do not apply for benefits because of high earnings.
[b] Ratio of estimated benefits that would be paid under liberalization to benefits actually paid in 1972 to affected persons.
[c] Exemption amounts based on BLS Older Couples' Budget.
Source: Simulations.

both tend to give a higher proportion of the resulting gains to lower income groups.

For all the above cases it is assumed that those age 62 to 64 retire at the first opportunity (i.e., before age 65). Those in this age range may have earnings more evenly distributed than workers over age 64. Hence, the proportion of benefits going to the higher income groups for those over age 64 would probably be even larger.

The Costs of Test Liberalization

Table 5 shows how the costs of the new social security payments to affected persons under each liberalized test relate to benefits paid out in 1972 under the existing test. The ratio of new costs to old costs is shown for each alternative.

What is immediately apparent from Table 5 is the much higher cost of the no-test alternative. *Except for alternative 4, all liberalizations are less than half the cost of abolishing the retirement test.* This suggests that significant liberalization is possible without the high costs associated with no test.

Comparing again the most liberal of the tier tests (4 and 8) with the combined-income test (9), we see that the two-tier test is the most expensive. The three-tier and combined-income test are about equal in cost, but (see Table 4) with the three-tier test a larger proportion of the gains go to the lower family income groups (below $10,000).

Lingg (1975) reports that in 1971 the Social Security Administration paid out $900 million in benefits to retired worker beneficiaries and their entitled dependents *who were affected by the test* ($2.2 billion in benefits were withheld). Using this benefit payment figure we can calculate a rough cost estimate for the various alternative tests discussed above.

Using the $0.9 billion cost in 1971 for beneficiaries with benefits reduced by the test in that year, we can make a rough estimate that introducing the most liberal of the three-tier tests in 1972 would have cost around $2 billion ($0.9 billion × 2.39). About $300 million of this cost would have gone to aged persons with family income under $5,000; about $1 billion would have gone to those with family income between $5,000 and $10,000. The average *increase* in benefits for the year would have been $562 and $615, respectively. Of course, if liberalization of the test results in a net increase in persons in the work force, then the net costs of liberalization would be lower as a result of the rise in payroll tax revenues.

SUMMARY

Prior discussions about changing the social security retirement test have usually focused on the current test versus abolishing the test. This article presents results of an investigation which explored ten liberalization alternatives. Estimates were made for 1972 of the distribution of pension gains by the aged affected by the retirement test in that year. Since it is frequently asserted that liberalizing or abolishing the retirement test primarily benefits higher income groups, benefits were analyzed by determining the proportion of additional benefits paid out to aged persons grouped by family income.

It was found that significant liberalization of the test could occur without the benefits going primarily to the higher income aged. This finding differs from the case of complete abolition of the test; the analysis confirms that abolition would result in more than half the benefits going to those with family income above $10,000 and also one-fifth going to those with family incomes of $20,000 or more.

The two- and three-tier alternatives did not produce very different distributions of gains. A combined social security and earnings test resulted in a higher proportion of benefits going to upper income groups. Cost-wise the three-tier alternatives resulted in a smaller amount of new benefits and consequently a lower total cost.

Thus the three-tier test has good distributional attributes and keeps total costs down. One negative aspect of a three-tier test, given a desire for simplicity and ease of understanding of social security rules, is that it is more complicated to understand.

As with almost all policy decisions, determining how best to change the retirement test requires considering various trade-offs among end objectives. The analysis presented here has attempted to show some of the distributional and cost differences implied by various liberalizations of the retirement test.

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Attachments to the Prepared Statement of Anthony J. Pellechio

Table 1

Earnings Distribution of Workers Age 65-71 in 1966-1975

Earnings Brackets	Percentage of Workers									
	1966	1967	1963	1969	1970	1971	1972	1973	1974	1975
1- 100.	5.3	3.2	2.3	2.6	6.0	3.2	3.4	2.4	2.3	3.2
101- 200.	2.7	2.5	2.2	2.0	3.2	1.8	2.2	2.6	2.0	2.3
201- 300.	2.3	1.9	2.4	2.0	3.5	1.5	2.3	1.6	2.1	2.4
301- 400.	1.7	1.9	1.6	1.7	2.3	2.3	1.7	1.6	1.2	1.8
401- 500.	2.5	2.8	2.5	2.0	2.6	2.0	2.3	1.5	1.9	2.0
501- 600.	3.6	1.7	2.8	2.3	1.7	2.1	2.3	2.9	2.8	1.9
601- 700.	2.3	3.4	2.8	2.5	2.3	1.9	2.0	2.0	1.3	2.5
701- 800.	3.7	2.4	1.7	2.0	2.1	1.9	2.8	1.8	2.1	1.6
801- 900.	2.2	2.8	1.9	2.8	2.0	2.3	1.8	1.8	2.1	1.2
901-1000.	2.8	2.7	2.9	2.4	1.9	1.8	3.0	2.2	1.5	1.0
1001-1100.	3.2	2.5	2.7	1.7	1.6	2.3	2.0	1.5	1.7	1.6
1101-1200.	2.6	4.1	4.1	2.5	3.9	2.5	2.2	1.7	2.0	2.4
1201-1300.	2.7	3.4	2.3	2.3	2.6	2.6	1.7	2.0	1.7	1.8
1301-1400.	3.6	2.6	2.7	2.7	1.7	2.1	1.8	2.5	1.6	1.5
1401-1500.	5.5	6.3	2.9	2.3	2.8	3.6	2.6	2.5	2.0	2.6
1501-1600.	2.4	2.4	3.8	4.5	3.1	4.0	4.3	2.4	1.8	2.2
1601-1700.	0.7	1.7	6.4	6.6	7.9	8.9	9.5	2.7	2.0	2.1
1701-1800.	1.6	1.1	1.3	1.9	2.0	1.9	1.8	3.0	2.8	1.2
1801-1900.	0.7	0.7	0.7	1.6	1.1	1.9	1.7	2.8	2.2	1.5
1901-2000.	0.9	0.7	1.0	1.8	1.3	1.4	0.6	3.1	2.2	1.5
2001-2100.	0.6	0.6	0.7	1.4	1.1	0.6	0.8	6.3	3.3	2.4
2101-2200.	0.5	0.8	0.3	0.7	0.6	0.7	0.7	1.7	2.2	2.4
2201-2300.	0.2	0.3	0.6	0.8	0.8	0.4	0.5	1.3	2.5	1.9
2301-2400.	0.9	0.5	1.3	0.6	0.8	0.4	0.8	1.1	6.1	3.1
2401-2500.	0.5	0.5	0.5	0.7	0.7	0.8	0.4	0.6	1.5	4.3
2501-2600.	0.9	0.6	0.7	0.3	0.4	0.2	0.3	0.3	1.1	4.2
2601-2700.	1.5	1.2	0.4	0.6	0.6	0.9	1.0	1.2	0.9	0.9
2701-2800.	0.5	1.3	0.9	0.6	0.5	0.3	0.7	0.5	0.9	0.6
2801-2900.	0.7	1.0	0.4	0.3	0.7	0.3	0.5	0.4	0.7	0.7
2901-3000.	1.0	0.8	1.1	0.5	0.6	0.3	0.3	0.6	0.5	0.7

⋮

Table 1 (continued)

	Percentage of Workers									
	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975
:	(Percentages in brackets above $3,000 up to the MTE* in each year average less than 1/2 percent.)									
MTE*	14.0	14.7	12.5	14.5	12.6	18.1	14.9	15.2	18.1	18.3
Population (thousands)	1,796	1,943	2,156	2,273	2,640	2,273	2,260	2,388	2,288	2,115

*MTE denotes maximum earnings taxable under social security; these were $6,600 in 1966-67, $7,800 in 1968-71, $9,000 in 1972, $10,800 in 1973, $13,200 in 1974 and $14,100 in 1975.

Table 2

Year	Percentage Increase	
	Exempt Amount	Total Earnings of Workers Age 65-71 Earning the Exempt Amount or less
1968	12%	39%
1973	25%	30%
1974	14%	13%
1975	6%	1%

Table 3

Earnings Distributions of Workers Age 72 and Over in 1966-1975

Earnings Brackets	Percentage of Workers									
	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975
1- 100.	4.6	3.4	5.5	3.3	11.7	4.7	4.1	2.5	3.4	3.2
101- 200.	2.9	4.5	1.8	1.9	7.0	2.5	2.4	3.2	3.0	2.3
201- 300.	4.1	3.4	2.0	3.4	5.5	2.0	1.9	3.5	2.0	2.4
301- 400.	3.3	2.1	2.6	1.4	3.5	0.9	0.9	3.6	2.3	2.5
401- 500.	2.5	5.2	3.2	1.8	3.7	3.0	2.1	2.5	2.1	1.3
501- 600.	2.9	4.0	4.6	4.7	3.5	2.4	3.1	3.6	2.6	3.1
601- 700.	2.5	1.8	4.5	3.5	2.2	2.0	2.5	2.2	1.6	2.9
701- 800.	3.4	5.4	3.2	1.5	2.8	2.4	4.5	3.4	3.6	3.1
801- 900.	2.4	2.7	2.8	4.9	2.8	3.4	2.0	2.4	2.4	1.3
901- 1000.	3.7	1.8	3.6	2.6	2.3	2.7	1.4	2.3	2.6	3.0
1001 - 1100.	2.7	2.2	3.6	4.4	2.6	2.6	3.5	2.1	1.0	2.7
1101 - 1200.	3.6	3.8	1.6	2.2	3.1	3.3	4.0	3.5	2.4	3.2
1201 - 1300.	4.6	2.0	3.8	3.3	1.5	2.5	3.3	1.8	3.4	1.8
1301 - 1400.	3.5	1.9	1.5	2.0	2.5	4.1	1.9	2.2	2.5	2.4
1401 - 1500.	2.6	4.7	4.3	1.2	1.9	3.5	2.5	2.7	2.8	2.3
1501 - 1600.	2.5	3.0	2.2	3.4	1.3	1.6	4.2	1.6	1.0	2.7
1601 - 1700.	1.8	1.8	1.8	3.5	2.7	3.5	2.7	1.1	1.7	2.1
1701 - 1800.	1.5	3.0	3.4	2.1	2.1	1.8	3.4	3.5	1.8	1.5
1801 - 1900.	1.3	2.1	1.6	2.6	2.1	2.2	1.3	2.3	2.0	1.8
1901 - 2000.	2.0	1.3	1.8	1.7	1.3	3.2	1.4	0.7	0.9	1.6
2001 - 2100.	1.7	2.6	1.8	2.5	1.8	1.9	2.3	3.2	3.1	2.3
2101 - 2200.	3.5	1.8	0.6	1.8	0.5	1.5	1.7	1.0	1.4	2.2
2201 - 2300.	1.9	1.1	0.6	0.7	1.4	1.0	1.2	1.4	1.2	0.9
2301 - 2400.	1.8	2.4	0.6	0.5	0.1	1.0	0.4	0.8	2.0	2.6
2401 - 2500.	0.3	0.9	0.7	1.4	1.0	1.4	1.3	1.3	0.2	2.4
2501 - 2600.	1.5	0.5	0.8	1.4	1.1	0.7	1.1	0.5	0.9	2.4
2601 - 2700.	1.4	0.3	0.6	1.2	0.7	0.4	0.5	0.8	2.2	0.3
2701 - 2800.	1.0	1.0	1.7	1.1	0.5	0.9	0.6	1.2	0.6	1.1
2801 - 2900.	0.3	0.8	0.6	0.9	0.5	0.3	0.7	1.6	1.0	0.9
2901 - 3000.	0.8	1.3	0.9	0.8	1.1	1.3	0.6	1.1	1.7	1.5

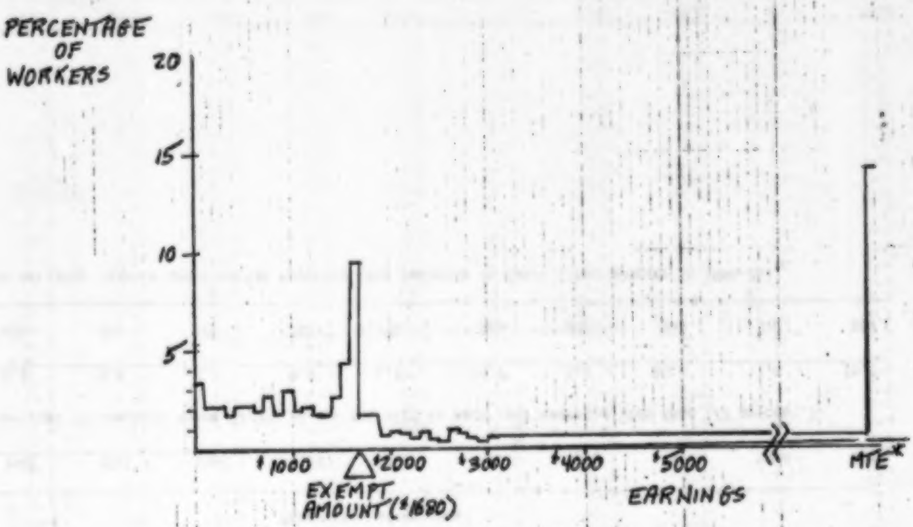
Table 3 (continued)

	Percentage of Workers									
	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975
⋮	(Percentages in brackets above $3,000 up the the MTE* in each year averaged less than 1/2 percent.)									
MTE*	9.5	9.4	8.2	9.3	6.7	10.2	9.0	10.2	11.4	10.2
Population (thousands)	605	656	729	762	1,338	829	908	953	932	869

*MTE denotes maximum earnings taxable under social security (see footnote to Table 1 for amounts in 1966-75).

FIGURE 1

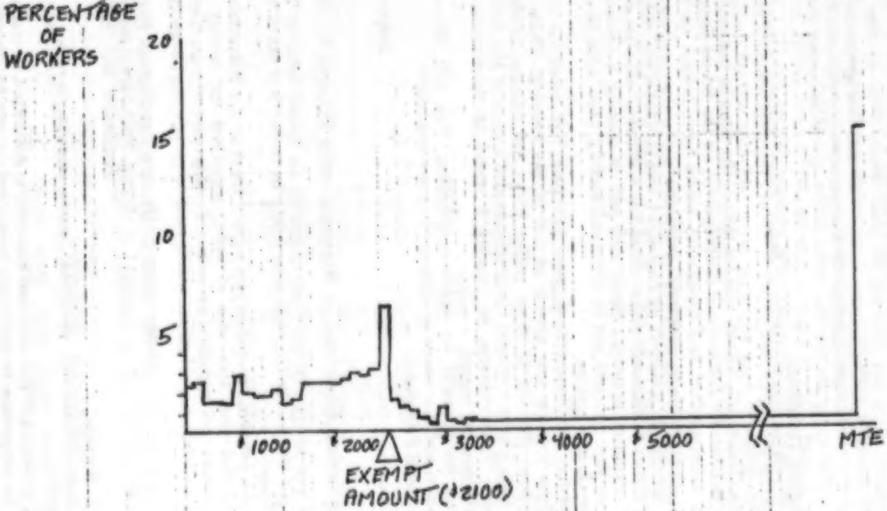
EARNINGS DISTRIBUTION OF WORKERS AGE 65-71 IN 1972



* MTE DENOTES THE MAXIMUM TAXABLE EARNINGS OF $9000 IN 1972

FIGURE 2

EARNINGS DISTRIBUTION OF WORKERS AGE 65-71 IN 1973



* MTE DENOTES THE MAXIMUM TAXABLE EARNINGS OF $10,800 IN 1973

APPENDIX 4

SELECT COMMITTEE ON AGING,
SUBCOMMITTEE ON RETIREMENT INCOME AND EMPLOYMENT,
Washington, D.C., July 21, 1980.

Mr. LAWRENCE THOMPSON,
Associate Commissioner for Office of Policy, Social Security Administration, Washington, D.C.

DEAR MR. THOMPSON: Thank you for taking the time to testify before the Subcommittee on Retirement Income and Employment on the Social Security earnings test. Your well substantiated and thoughtful views have helped us to understand the issues surrounding this controversial provision.

After a hearing on a subject as important and controversial as this, I request staff to write a report summarizing the issues and testimony with proposed recommendations for Committee approval. Since staff will be writing a report on the "earnings test", I hope that you will not be inconvenienced if they need to communicate with you further on this matter.

My colleague, the Honorable Eugene Atkinson, has asked me to forward to you a few questions that he was unable to ask at the hearing. These are based on his concerns about the use of gross rather than net income in determining Social Security taxes. I have enclosed his questions and a copy of Mr. Atkinson's statement for your use. Your response by August 6 would be appreciated so that we can complete the hearing record.

Again, we are grateful for your contribution. You will receive a copy of the hearing record and the report as soon as they are available.

Peace and Friendship,

JOHN L. BURTON,
Chairman.

QUESTIONS SUBMITTED BY REPRESENTATIVE EUGENE V. ATKINSON

1. Would you happen to have any statistics on Social Security beneficiaries who have exceeded the test ceiling but who would be under it if taxes were not included in gross income?
2. Could you get those statistics and supply them to the Subcommittee?
3. Do you feel that this idea of being penalized for paying taxes is unfair?
4. What would you recommend to rectify this inequity in the present system?
5. Do you feel that our solutions would help to rectify the inequity?

DEPARTMENT OF HEALTH AND HUMAN SERVICES,
SOCIAL SECURITY ADMINISTRATION,
Baltimore, Md., September 4, 1980.

Hon. JOHN L. BURTON,
Chairman, Subcommittee on Retirement Income and Employment, Washington, D.C.

DEAR MR. CHAIRMAN: The attached material is submitted in response to your July 21 request for responses to questions submitted to you by Representative Eugene Atkinson. If you have additional questions, please let me know.

Sincerely yours,

LAWRENCE H. THOMPSON,
Associate Commissioner for Policy.

Enclosure

RESPONSES TO QUESTIONS SUBMITTED BY REPRESENTATIVE EUGENE ATKINSON

Question 1. Would you happen to have any statistics on Social Security beneficiaries who have exceeded the test ceiling but who would be under it if taxes were not included in gross income?

Answer. No. Our Office of Research and Statistics, which gathers statistical information on the social security program and conducts studies on the effects of changes in the program, does not have data on the gross and net earnings of individual beneficiaries under age 72 by earnings levels. Indeed, we have no information on the Federal, State, and local income taxes and local property taxes paid by social security beneficiaries. However, we do have statistics on the number of retired-worker beneficiaries under age 72 who are affected by the earnings test and the percentage distribution by the amount of their earnings. (See Tables 1. and 2.) These statistics (the latest available) are for 1977 when the earnings test exempt amount was $3,000 for all beneficiaries.

Table 2 shows that of the 1,181,000 retired workers age 62–72 who were affected by the retirement test in 1977, more than 85 percent has gross earnings that exceeded the $3,000 annual exempt amount by at least $1,000 and could, therefore, be assumed to also have had net earnings in excess of $3,000. It seems unlikely that many people at these earnings levels would have had net earnings (after Federal, State and local taxes) of less than $3,000 exempt amount of 1977. Also, it might be noted that the total 1,181,000 retired workers affected by the test constitute only 12 percent of all retired workers age 62–72 in 1977. Thus, only about 1.8 percent of the retired workers subject to the test had gross earnings that exceeded the $3,000 exempt amount by a small enough amount that their net earnings might have been below that level.

TABLE 1.—NUMBER AND PERCENTAGE DISTRIBUTION OF RETIRED-WORKER BENEFICIARIES UNDER AGE 72 ON ROLLS AT END OF YEAR AND OF THOSE AFFECTED BY EARNINGS TEST, BY SEX AND AGE GROUP, 1977

Sex and Age	Retired-workers beneficiaries				
	On rolls at end of year		Affected by earnings test		
	Number	Percentage distribution	Number	Percent on rolls	Percent eligible for benefits [1]
Total	9,875,559	100.0	1,181,000	12.0	9.5
Men	5,540,929	56.1	822,252	14.8	12.0
Women	4,334,626	43.9	358,748	8.3	6.5
Men	5,540,929	100.0	822,252	14.8	12.0
62–64	955,239	17.2	122,767	12.9	5.6
65–71	4,585,690	82.8	699,485	15.3	14.9
Women	4,334,630	100.0	358,748	8.3	6.5
62–64	957,384	22.1	75,178	7.9	4.2
65–71	3,377,246	77.9	283,570	8.4	7.5

[1] Percent of those aged 62–71 who would be eligible to receive retired-worker benefits at end of year. Excludes disabled-worker beneficiaries aged 62–64.

TABLE 2.—NUMBER OF RETIRED-WORKER BENEFICIARIES AFFECTED BY EARNINGS TEST AND PERCENTAGE DISTRIBUTION BY AMOUNT OF EARNINGS, BY SEX AND AGE GROUP

Retired-worker beneficiary by sex and age group	Number	Percent distribution, by amount of earnings							
		Total	Less than $4,000	$4,000–6,999	$7,000–9,999	$10,000–12,999	$13,000–16,499	$16,500 and over	Unknown
Men	822,252	100.0	11.9	18.1	15.3	12.3	10.1	23.6	8.7
Aged 62–64	122,767	100.0	18.9	32.6	20.1	10.8	6.3	8.5	2.8
Aged 65–71	699,485	100.0	10.6	15.6	14.5	12.6	10.8	26.2	9.7
Women	358,748	100.0	21.5	32.0	20.8	10.7	5.4	5.4	4.2
Aged 62–64	75,178	100.0	34.6	44.1	13.0	3.6	1.7	1.7	1.3
Aged 65–71	283,570	100.0	18.0	28.8	22.8	12.6	6.4	6.4	5.0
Total	1,181,000	100.0	14.8	22.3	17.0	11.8	8.7	18.1	7.3
Aged 62–64	197,945	100.0	24.9	37.0	17.4	8.1	4.6	5.9	2.2
Aged 65–71	983,055	100.0	12.7	19.4	16.9	12.6	9.7	20.5	8.3

Question 2. Could you get those statistics and supply them to the Subcommittee?

Answer. We doubt that any agency has the specific information you request. To obtain the data, we would have to conduct a survey of the beneficiaries affected by the earnings test, possibly with the concurrence of the beneficiaries, including a cross-check with tax records. Such a survey would be an enormous, costly, and time-consuming undertaking; the results might well be seriously flawed because many people would consider a request for information on their tax liabilities an invasion of their privacy.

Although the specific data you request are not available, and probably could not be developed in a reasonable time frame or at a reasonable cost, there are various ways of developing rough estimates of the relationship between gross and net

best copy available

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SOCIAL SECURITY EARNINGS TEST

HEARING

BEFORE THE

SUBCOMMITTEE ON RETIREMENT INCOME AND EMPLOYMENT

OF THE

SELECT COMMITTEE ON AGING HOUSE OF REPRESENTATIVES

NINETY-SIXTH CONGRESS

SECOND SESSION

June 26, 1980

Printed for the use of the Select Committee on Aging

Comm. Pub. No. 96-263

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SOCIAL SECURITY EARNINGS TEST

THURSDAY, JUNE 26, 1980

U.S. HOUSE OF REPRESENTATIVES,
SELECT COMMITTEE ON AGING,
SUBCOMMITTEE ON RETIREMENT INCOME AND EMPLOYMENT,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:30 a.m., in room 2203, Rayburn House Office Building, Hon. John L. Burton (chairman of the subcommittee) presiding.

Members present: Representatives John L. Burton of California, Oakar of Ohio, Evans of Indiana, Ferraro of New York, Wampler of Virginia, Dornan of California, and Green of New York.

Also present: Representatives Pepper of Florida, Biaggi of New York, Lloyd of California, Atkinson of Pennsylvania, Grassley of Iowa, and Hopkins of Kentucky.

Staff present: Merrill S. Randol, staff director and counsel; Valinda Jones, professional staff member; Michele Irving, staff assistant; Nancy E. Hobbs, minority staff director; and Mary Elizabeth Garver, minority staff assistant.

OPENING STATEMENT OF CHAIRMAN JOHN L. BURTON

Mr. BURTON. The Subcommittee on Retirement Income and Employment of the Select Committee on Aging will come to order.

The subject of today's hearing is the social security earnings test. We are all aware of the hardship on the elderly collecting social security. If the elderly earn certain amounts of income, they find their social security checks reduced.

Yet, seniors with unearned income, such as in the case of a dear, departed friend of mine who was a multimillionaire, receive a full social security check every month. My friend's income was all in dividends and profits not wages.

I would ask unanimous consent to revise and extend my remarks, and put them in the record.

[The prepared statement of Representative John L. Burton follows:]

PREPARED STATEMENT OF REPRESENTATIVE JOHN L. BURTON

Three months ago members of this subcommittee heard a proposal that one-half of social security benefits should be taxed. We rejected that idea totally. Today we're going to examine a provision that many people think is just as harsh a tax on retirees who want to work—the social security earnings test which makes retirees forfeit $1 in benefits for every $2 they earn above $5,000. The test cuts all or part of the benefits of over one million retirees.

When the Congress passed the ADEA Amendments two years ago, we gave older workers the green light to continue working to age 70. But we still give conflicting signals under Social Security. A 60-year-old widow receiving social security will have benefits taken away if she earns more than $3,720; but a retiree age 67 gets to keep $5,000 before the benefits are touched, and a retiree 72 or older can earn any amount and get the full social security benefit.

I'd like to be able to eliminate the earnings test and I am sure that most of my colleagues would, too. Every week I receive letters demanding an end to the test because people are angry that they will lose some or all of their benefits if they stay employed.

When the test discourages work, it hurts both the country and the affected individuals. If experienced people stop working, the Nation loses trained, productive help. The workers lose extra inflation protection, and face poorer health and increased isolation. But it's also true that if we eliminated the earnings test right now, we'd have to find an extra billion dollars or so to make up the amount it would cost the social security old-age trust fund.

The social security trustees have just reported that the old-age trust fund already may not be able to pay its benefits in 1982 unless we find some more revenues. And, though this morning we will hear conflicting estimates of the cost of eliminating the test, most people will have to admit that we will spend more than we were planning to spend each year if we eliminate the earnings test. That's counting any increased social security payroll tax revenues.

Unless we change the financing of the program, we would have to increase the taxes workers pay or cut other benefits to make up the additional cost. I hope our witnesses today will look at better ways to finance social security so we can make the reforms everyone seems to be advocating.

For people who have to leave work, social security surveys have found that more than half of the workers in jobs without compulsory retirement said they retired because of poor health or because their employer no longer wanted them to stay.

Should we use an extra billion dollars to increase benefits for low-income retirees who can't work? Or should we use it to make working more attractive for people who are able to work and lucky enough to have a job?

Only 2 percent of the retirees questioned in a recent opinion poll said that the limit on the amount they could earn without losing benefits was a problem. But 39 percent of the retirees thought that the inadequacy of benefits was a real problem.

Eliminating the earnings test won't make workers who have to retire because of poor health well enough to work again, and it won't make jobs for the 94,000 people 65 and older who are already out of work and still looking for a job. That's especially true at a time when the unemployment rate is 7.8 percent and probably still climbing.

Our responsibility at this hearing is to find out just how many people will be helped by eliminating the earnings test and at what cost, if any, to the rest of social security. None of us wants to keep work disincentives for older people. But setting that goal is easy: How to get there is our main question today.

Mr. Burton. At this time I will yield to the distinguished ranking member, the gentleman from Virginia, the Honorable William Wampler.

STATEMENT OF REPRESENTATIVE WILLIAM C. WAMPLER

Mr. Wampler. Thank you, Mr. Chairman.

I wish to commend you for holding this hearing on one of the most controversial issues concerning our Nation's social security system, the social security earnings test.

I think today we have witnesses who represent a wide variety of viewpoints. I particularly appreciate their participation in coming and sharing their views with us.

Mr. Chairman, we were very honored that Senator Barry Goldwater, one of the early authors of legislation to liberalize the earnings limitation, agreed to join us today, but we regret that he is unable to be with us this morning.

I understand his son, our distinguished colleague from California, Congressman Goldwater, will later in the hearings convey what his father's sentiments on this important issue are.

I would ask unanimous consent, Mr. Chairman, to revise and extend my remarks, and also those of our colleague, Mr. Shumway. I would also like to include in the appendix, statements prepared by Colin D. Campbell, Ph. D., professor of economics, Dartmouth

College, and Marshall R. Colberg, Ph. D., professor of economics, Florida State University.

[See appendix 2, p. 136, for material submitted by Representative Wampler.]

Mr. Burton. Without objection.

[The prepared statements of Representatives William C. Wampler and Norman D. Shumway follow:]

Prepared Statement of Representative William C. Wampler

Mr. Chairman, I wish to commend you for holding this hearing on one of the most controversial issues concerning our Nation's social security system—the "Social Security Earnings Test." Today's witnesses represent a wide variety of viewpoints and I appreciate their participation.

We were honored that Senator Barry Goldwater, one of the early authors of legislation to liberalize the earnings limitation, agreed to join us today. However, we are sorry that he is unable to be with us this morning. But he is well-represented by his son, Barry Jr., and we are pleased to have him convey his father's sentiments on this important issue. We also want to thank the Senator's aide, Terry Emerson, for his assistance with today's hearing.

The earnings limitation serves as a deterrent to older workers wishing to remain in the labor force. Thus, doing away with the earnings limitation would certainly impact on the decision to retire, as well as considerations to return to the labor force from retirement status. It is my opinion that, particularly during this time of economic instability, work disincentives such as the earnings limitation must be abolished.

In April of 1979 I introduced legislation, H.R. 3812, to amend Title II of the Social Security Act to remove the limitation upon the amount of outside income an individual may earn while receiving benefits. I am pleased that many of my colleagues here today have introduced similar legislation. As legislative history reveals, the earnings test has continually undergone liberalization. I feel confident that Congress will continue this trend.

The Office of the Actuary of the Social Security Administration estimates the cost of repealing the test in 1983 for persons over 65 is $2.1 billion. I am optimistic that dependency upon public assistance programs would be substantially reduced if older persons were given the opportunity to remain employed. If revenue offsets, estimated to total $1.7 billion, are taken into consideration, the cost of eliminating the earnings limitation for persons 65 years and over would total $400 million in 1983.

It is estimated that approximately 3 million older persons would directly benefit from abolishing the earnings test! The social and economic benefits of removing this disincentive to employment far outweigh the cost.

Mr. Chairman, again I admire your leadership in scheduling this hearing on the "Social Security Earnings Test." Action must be taken in order to provide older persons with the option to work and to receive the social security benefits they have earned.

Prepared Statement of Representative Norman D. Shumway

Mr. Chairman, I commend you for drawing our attention today to the outside earnings limitation that is currently imposed on social security recipients. You may be aware of the fact that I introduced legislation last year to amend Title II of the Social Security Act to remove the limitation upon the amount of income an individual may earn while receiving benefits thereunder. While it may seem that the bill is languishing in the House Ways and Means Committee, support for its provisions remains strong. I frequently hear from constituents and colleagues alike that the earnings limitation should be eliminated.

It certainly makes little sense, at a time when many of our senior citizens are struggling to make ends meet, to threaten social security recipients with a reduction in social security benefits if their outside income exceeds a certain level. Social security is a retirement program, not a welfare program. To deny full benefits to those who have paid into the system throughout their working careers, with the expectation that they would begin to reap the benefits at age 65, is literally a breach of contract between the Federal Government and the individual worker.

In fact, it is often those who find it most difficult to survive on fixed incomes during periods of high inflation who must rely on outside income. It is not wealthy individuals, who often have income-producing investments, who suffer under the earnings limitation—it is those who can least afford it.

Further, the earnings limitation acts as a disincentive to work in a productive capacity. The attitude toward retirement in recent years has made clear that the 65-

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year limit is somewhat arbitrary; many are choosing and, in fact, are encouraged to work beyond this age. Not only is this good for the economy, it is good for the individuals involved. Yet, because of this outdated provision, we are formally penalizing such activity.

Mr. Chairman, legislation similar to mine has been introduced in the past. Many Members share my concerns. I look forward to today's testimony and a chance to take yet another look at the concept of earnings limitation.

Mr. BURTON. At this time I yield to the gentleman from New York, one of the more active and productive members of the Select Committee on Aging, as well as the entire Congress, the Honorable Mario Biaggi.

STATEMENT OF REPRESENTATIVE MARIO BIAGGI

Mr. BIAGGI. Thank you, Mr. Chairman.

I would like to commend you, Mr. Burton, the distinguished chairman of the Subcommittee on Retirement Income and Employment, for convening this important meeting. My colleague Mr. Grassley and I specifically requested this hearing, and with the full support and leadership of Chairman Claude Pepper, our request was granted.

From the outset, I wish to indicate my support for the eventual repeal of the outside earnings test. This is not a new position for me. I have urged this since entering Congress in 1969. Happily, it has been modified since that period.

The retirement test, also known as the earnings limitation of the old age, survivors, and disability insurance—OASDI—system continues to be one of the most discriminatory provisions of the Social Security Act.

The retirement test applies to all retirees covered under social security except persons over the age of 72, and beginning in 1982, persons 70 years and older.

When earnings exceed certain amounts prescribed by law—$5,000 in 1980; $5,500 in 1981; and $6,000 in 1982 for those over the age of 65—individuals are subject to a decrease in social security benefits by $1 for every $2 earned above the exempt amount.

This schedule of benefit reduction remains in effect up to a point, known as the overall earnings limit when the worker receives no social security benefits.

The effect of the outside earnings limitation on a workers total family income, then, is tantamount to a marginal tax of 50 percent on earnings. I firmly believe that this provision is unfair. It is arbitrary and restricts the rights of older people to enjoy a decent standard of living. In past Congresses I have sponsored, with Chairman Claude Pepper, legislation to eliminate it.

Interestingly, when the House passed its version of the Social Security Act in 1935, it included no provision for an earnings test. Soon thereafter, however, it was made a part of the final act. The long legislative history of the earnings test reveals a marked trend toward its liberalization.

The 1935 Social Security Act originally contained a provision which prohibited payment of benefits during any month that a beneficiary earned wages from regular employment.

In 1939, amendments to the act defined regular employment to mean that no individual earning more than $14.99 in a given month could receive benefits. Since then, Congress has modified the outside earnings limitation a dozen ways.

In 1950 amendments increased the limitation from $14.99 to $50.

In 1952 the test for persons over the age of 72 was eliminated and the monthly income was increased to $75.

In 1954 the exempt age was lowered from 75 to 72 and an annual as well as monthly test was instituted.

In 1958 the monthly limit was increased to $100.

In 1960 a two-tiered withholding system was created whereby an individual would forfeit $1 in benefits for every $2 of earnings above $1,200 and below $1,500; and forfeit $1 in benefits for every $1 of earnings over $1,500.

In 1972 the $1 for $1 reduction clause was eliminated and the annual exempt amount was increased from $1,680 to $2,100.

In 1977 the age at which the test applies was lowered to 70, beginning in 1982.

The number of individuals affected by the test is significant. In 1975 approximately 1.655 million beneficiaries were affected by the test. Out of this group, 1.318 million persons, or 14 percent of all beneficiaries, were retired workers between the ages of 62 and 71.

Had the earnings test not been in effect, the amount payable to this overall group would have totaled $4.8 billion. The fact is, though, that 60 percent, or about $3 billion in benefits, was withheld because of the test. Moreover, 34 percent of all retired workers affected by the retirement test had all benefits withheld.

The repeal of the outside earnings limitation should be considered in both a civil rights and economic context. A parallel that comes to mind is the law which abolished mandatory retirement at age 65.

The relationship between the outside earnings limitation and the end of mandatory retirement is clear—the continuation of the earnings limitation thwarts the objectives of the Age Discrimination in Employment Act.

The Federal Government seems to have two voices—on the one hand, the 1978 age discrimination amendments mandate that persons are free to work up to the age of 70.

Yet, on the other hand, the Social Security Act discriminates against the millions of Americans between the ages of 65 and 70 who wish to continue to work by imposing a 50-percent tax on their earnings. These citizens are not only subject to the loss of benefits, but also must continue to pay OASDHI tax contributions and, if liable, local, State, and Federal income taxes.

For many individuals, the high cost of living leaves little choice but to continue working. Yet the net effect of the outside earnings limitation is as serious a disincentive to employment of older people as was mandatory retirement.

This not only makes it increasingly difficult for senior citizens to achieve economic security, but also makes more individuals dependent upon Government transfer payments.

Most of all, however, it is simply unjust to deny retirement benefits to people who have contributed to the social security system for many years. They are entitled to these benefits and to the right to work. The retirement test restricts these basic rights and should be eliminated.

I have adopted this position after carefully considering the issues related to cost. Those opposed to my views point to the costly effect of repealing the earnings test and to the negative financial prognosis of the old age and survivors insurance trust fund.

Yet, this expense could be offset somewhat by the greater numbers of individuals working and paying income and social security taxes.

The most immediate approach to addressing the systems short-term financial needs is to permit interfund transfers as proposed by the President. In the long run, Congress must pass legislation to permit the use of general revenue funds.

I specifically support the so-called one-third plan. This measure, originally proposed by former Congressman James Burke, would finance the Social Security system through one-third employer taxes, one-third employee taxes, and one-third general revenues.

I am convinced that the use of general revenues is inevitable if we are to insure the future of the social security system.

Permit me to conclude, Mr. Chairman, with an observation.

This past Friday I testified before the subcommittee responsible for making changes in the earnings limitation, the Social Security Subcommittee of the House Ways and Means Committee.

The hearing was called to ascertain why the infamous criminal, David Berkowitz, or Son of Sam, was able to receive social security disability benefits of $300 a month while in prison.

Although it now appears as though the particular case of David Berkowitz has in fact been resolved, the potential exists for thousands of other prison inmates to receive disability benefits while behind bars.

On the one hand, we find unrestricted disability benefits going to hardened criminals while on the other hand limitations are being placed on the ability of other social security recipients to receive their full benefits.

Where is the justice in this situation? The time has come for the repeal of the earnings limitation. It is outdated and cruel and in these economic times, and above all, contradictory to national efforts to promote the economic independence of senior citizens.

Mr. BURTON. Thank you, Mr. Biaggi.

Congresswoman Ferraro of New York, do you want to make an opening statement?

Ms. FERRARO. I do, Mr. Chairman, but I will have it inserted in the record. I would like to hear what the witnesses have to say.

Mr. BURTON. Without objection, that will be the order.

[The prepared statement of Representative Geraldine A. Ferraro follows:]

PREPARED STATEMENT OF REPRESENTATIVE GERALDINE A. FERRARO

Thank you Mr. Chairman. I remember the first hearings I participated in as a member of the Select Committee on Aging. Soon after the 96th Congress convened, Chairman Pepper held hearings on the impact of the proposed budget on the elderly. That budget contained the President's controversial recommendations that Congress eliminate the lump-sum death benefit for social security recipients, that we eliminate the minimum benefit, and other, equally severe recommendations.

Soon after the hearings began, it became evident that most of the members of the committee were primarily concerned, as were their constituents, not with the dollar figures in the budget recommendations, but with the proposals that related to reducing or eliminating social security benefits.

For me, those issues were cut and dry—black and white. There was no doubt in my mind that the rationale for advancing them was ill-advised, and that they threatened the income security of thousands of retirees. I recall, for example, extensive testimony on the elimination of the lump sum death benefit $255 dollars. The arguments for adopting that proposal were that the figure was an unrealistic amount that could not come close to meeting funeral expenses, and that if a beneficiary or his or her family was in such dire need, they could always have those costs picked up by some form of general assistance.

I was appalled. Here, at one of my first hearings as a member of Congress, I listened to experts tell us that we should urge our constituents—our elderly and proud constituents—to go on welfare.

Today, we are considering a matter which is not as cut and dry. Certainly the issues before the subcommittee this morning are not black and white. I am sitting here this morning with an open mind, willing to listen to both sides.

Yes, I would, if the social security trust funds were in the soundest of condition today, with assurances that they would remain so tomorrow, urge the elimination of the retirement test. Yes, I am concerned that the burden of this earnings test falls unfairly on the shoulders of those who can least afford it. I find neither the five thousand dollar figure for those between 65 and 72 or the three thousand seven hundred and twenty amount for those under age 65 to be realistic.

At the same time, in our efforts to address that inequitable situation we may be harming the trust funds and the solvency of the system in an irreversible way.

Given these valid, but competing concerns, the task that lies before this subcommittee, and the full House of Representatives will be a difficult one. It would be easy for us, as friends of the elderly and members of the committee, to flatly state on the basis of innate compassion, that we are in favor of liberalizing or eliminating the retirement test immediately. I hope that we all can balance our concerns for the 1.1 million beneficiaries subject to the earnings test against the fact that eliminating the test in 1982 would increase the cost of benefits by between two and seven billion dollars.

Let us not play one class of beneficiaries off against another. That is cause some to suffer in order to better the lot of others. But, at the same time, I hope that every member of this committee looks carefully at the long range effects of what we are discussing.

As I said earlier, the issue is not black and white. And, I am here with an open mind. I appreciate your calling these hearings, Mr. Chairman, and I look forward to the testimony of the witnesses. Although, I suspect that by the end of the proceedings the issue will still not be black and white.

Thank you.

Mr. BURTON. I have been given the prepared statements of several Members who have not yet arrived, and if there are no objections, I would like to submit them for the record at this point. Hearing no objection, so ordered.

[The prepared statements of Representatives Thomas J. Downey, Mary Rose Oakar, Lamar Gudger, S. William Green, John Paul Hammerschmidt, and Jim Lloyd follow:]

PREPARED STATEMENT OF REPRESENTATIVE THOMAS J. DOWNEY

Mr. Chairman, I would like to take this opportunity to express my strong opposition to the Social Security earnings test. The test is an unfortunate and discriminatory measure which discourages our senior citizens from holding jobs and takes needed fixed-income dollars out of their pockets in these highly inflationary times. Under existing law, the dollar figure for the test automatically increases each year, but with our present inflation rates, these earnings ceilings are having a drastic effect upon the quality of life which our senior citizens are being allowed to enjoy. The need for us to eliminate this oppressive practice should be apparent to all.

The experience which our senior citizens contribute to the work force is significant. Yet, with the earnings test acting as a strong employment disincentive, many are choosing to abandon jobs in which they have spent lifetimes, often long before they are really ready to do so. As a result, we are losing our loyal older workers from the labor force. One study has indicated that an increase in labor force participation at age 72 was due to removal of the retirement test. The earnings test is forcing skilled workers from the employment scene, eliminating tax dollars which they would contribute and lowering the overall national economic output. Our seniors deserve better treatment than this.

To continue allowing such small increases in the maximum allowable income, rather than eliminating this test altogether, would be particularly unwise in light of recent statistical data published by the Social Security Administration, the Department of Housing and Urban Development, and the Department of Health and Human Services. These figures show that O.A.S.D.I. benefits alone are not enough for our seniors to meet their monthly expenses. Therefore, it is quite often a must for these beneficiaries to supplement their O.A.S.D.I. income with some form of employment—unless, of course, they have large private pensions or interest incomes.

On Long Island, it has been estimated that the average monthly cost of living for a senior citizen is somewhere in the ball park of $900.00. Yet, the average senior citizen receives only $300.00 to $350.00 per month in benefits. That leaves $550.00 to $600.00 per month which they must supplement with some other source of income. The Social Security earnings test states that in 1980, the maximum income that may be earned by an elderly citizen without the one dollar for every two dollar deduction is $5,000.00 per year. Yet, this $5,000.00 amounts to only $416.67 per month, an amount which obviously is not enough to cover those remaining daily expenses mentioned previously. Then after that point, they are taxed 50 cents for every dollar earned. Once again, we see the senior citizen getting the short end of the stick.

One final point I would like to stress is that the earnings test takes away dollars which are received by our seniors in exchange for work on the job. Still, it ironically allows, under present law, for other retirees to earn dividends and interest in any amount while collecting full Social Security benefits. This structure is clearly biased in favor of the wealthy retiree who does not need to work to supplement his Social Security benefits. Why, Mr. Chairman, should we take dollars away from the man or women who continues to work, while we allow the more wealthy retired senior, living on dividends and interest, to keep every penny? Our society will not tolerate this attack on the pocket book of the older worker any longer.

This whole issue centers around the fact that our seniors have been paying into the Social Security program all their lives so that when they retire, they can grow old with some comfort and dignity. What proponents of this earnings test would do instead, is deprive these elderly of some of the future they may have left by denying them the funds needed to meet the daily expenses of living.

Prepared Statement of Representative Mary Rose Oakar

Mr. Chairman, I want to commend you for holding this hearing on so important a subject as the earnings test. It is one of the most controversial features of our social security system. Since 1960 Congress has passed no less than five laws affecting the earnings test. The trend of this legislation has been to liberalize the test. In 1960, a beneficiary lost $1 in benefits for every $2 earned annually above $1,200 and below $1,500. Today the amount of exempted earnings is $5,000. This trend is encouraging, but it does not solve the basic problems.

There are several features of the earnings test which concern me:

One. Our social security program was originally devised as an income replacement system for older Americans. However, it was expected that only a part of the lost income would be replaced by social security; the remainder would be picked up by the older worker through savings and participation in a pension plan. But for many, social security is their main source of income; it is, in effect, their pension. For instance, more than half of all couples in which one spouse was 65 or older relied on social security as their principal source of income. Nor is this income very often adequate. About one out of every seven persons aged 65 and older in 1977 had incomes below the poverty line; unmarried older women are disproportionately much poorer, accounting for 72 percent of all poor elderly persons. Average monthly benefits for women who retire at age 65 is only $243.50. Average monthly benefits for women who take an early retirement and thus a reduced benefit is only $187.90. Regretfully, in light of these statistics indicating the inadequacy of social security benefits for many, social security is alone among the many private and public pension plans in imposing an earnings test.

Two. The rapidly escalating cost of living in the last twenty years has wiped out the lifetime savings of many older Americans—their nest egg for retirement. Because social security benefits are designed to be supplemental and not primary, employment beyond the normal retirement age has become an economic necessity for many. To penalize those who must work by subjecting them to an earnings test which may reduce their benefits, seems to me unreasonable and cruel.

Three. Present law removes the earnings test for individuals 72 and over. I believe this is arbitrary. Such a provision tends to discourage older Americans from working past 65, and runs counter to the spirit of federal law which has prohibited forced retirement before age 70.

Four. Our older Americans are an important national resource. Their skills and experience, based upon a lifetime of work, represent an important part of our country's productive potential. To discourage this segment of our population from working by imposing an earnings test may restrict our economic output.

Older Americans should not be hindered from working purely on the basis of age; older Americans have a right to live out their lives in dignity and decency; the work experience and skills of older Americans comprise a national economic treasure; older Americans should have the freedom to retire, or continue working without penalty, as their needs or wishes dictate.

These are values which I think we can all embrace. Americans who contribute to social security should receive their benefits, whether they work or retire in old age. Therefore, we should eliminate the earnings test.

PREPARED STATEMENT OF REPRESENTATIVE LAMAR GUDGER

Mr. Chairman, I thank you for your alert leadership of this subcommittee and particularly for scheduling a hearing on an area of considerable concern to the residents of my own 11th District in North Carolina.

Inflation has hit all of us hard, but nowhere has it struck harder than at our senior citizens who have seen their golden years tarnished by the dwindling purchase power of the dollar. The elderly of my district, who had planned to live comfortably on a mix of their social security and pensions or savings now find they must go to work at least part time just to make ends meet.

The earnings test, however, puts a brake on just how much they dare earn before this work becomes itself a disadvantage. Our senior citizens are, as the saying goes, between a rock and a hard place.

I trust that the testimony to be heard will go far toward at least liberalizing the earnings test and that action coming out of this hearing will be swift. Each day of delay only puts a further crimp in senior budgets across this country. The elderly of my district are proud people who have worked hard all their years. They want no handouts, only a program that treats them fairly and does not penalize them if they want to work a little more to make life just a tad more pleasant in their waning years.

PREPARED STATEMENT OF REPRESENTATIVE S. WILLIAM GREEN

Mr. Chairman, I appreciate having the opportunity to participate in today's hearings on the earnings limitation test. I would like to thank you, Mr. Chairman for holding these hearings. I know of no feature of the Social Security system that causes more annoyance among senior citizens then the earnings limitation test applicable to those between the ages of 65 and 71 years of age, and I am pleased that the Committee has taken positive action to address this issue.

In my contact with constituents, I have learned that the earnings limitation test is a policy which angers the elderly, and creates a disincentive to work. I have introduced a bill, H.R. 2650, which deals with the financial problems of the Social Security system, and proposes a method by which the system could be made sound again. Among other things, the bill eliminates the earnings limitation except for those persons who are under retirement age and are receiving Social Security.

Seniors are participating in all sectors of society today, and as they are making contributions to all aspects of society, I believe it is imperative to eliminate this test for persons who are retired. Individuals have a right to earn whatever they are able to earn without fear that the benefits of their work will be taken away from them. I look forward to hearing from all the witnesses on this issue.

PREPARED STATEMENT OF REPRESENTATIVE JOHN PAUL HAMMERSCHMIDT

Mr. Chairman, I am glad that you have decided to hold hearings on the earnings limitation test. After a good deal of consideration, I, as have many other members of Congress, introduced legislation to eliminate the earnings limitation test. I am aware that there are numerous arguments for retaining the test primarily the concept that social security was designed to provide social insurance against a decrease in earnings rather than to provide annuities at a fixed age such as in private insurance.

I believe, however, that the ideas that led to the creation of social security in its particular form are not as valid today as they were in 1935. One of the underlying reasons for initiating social security was that during the Depression there was a desire to discourage older workers from remaining in the work force and instead open up job opportunities for younger workers. I don't believe that our current economy requires these restrictive measures; nor do I believe that we can afford to lose the skill and expertise of our mature employees.

The more critical issue is that maintaining this provision causes financial difficulties for many older people who need to work to supplement their social security benefits. In general, the social security replacement rate for an individual worker who has earned an average income is 44 percent of his gross earnings. Right now the average retired worker living alone receives only $289.00 per month.

I know that concern has been voiced over the effect removing the earnings limitation test would have on the trust fund. It has been estimated that eliminating the test for workers age 65 to 69 would cost $2.1 billion. Neither I nor my colleagues would suggest any change that would jeopardize the system. But, it is also true that the increase in employment would generate millions of dollars in payroll taxes and individual income taxes and that these monies would significantly reduce the cost of eliminating the test.

Mr. Chairman, I thank you for the opportunity to make these remarks and look forward to hearing the views of our witnesses.

Prepared Statement of Representative Jim Lloyd

Mr. Chairman, I'd like to thank you for kindly permitting me to join you today as you discuss the social security earnings limitation. This is a subject in which I take great interest. In 1978 I introduced legislation, which was reintroduced in the 96th Congress as H.R. 543, to eliminate the earnings limitation test. I might point out that a number of my colleagues, both in the House and Senate, also feel strongly enough about this issue to have introduced their own bills to eliminate this restriction.

I am particularly delighted and proud to have one of my own constituents here today to testify as to the need for the elimination of the earnings test. Dr. George Gibbs, a certified public accountant and Emeritus Professor of Accountancy and Economics at Claremont Men's College in Claremont, California, has been involved with this issue since 1964. Just this January he testified before the Human Services Subcommittee at a hearing in the 35th District, and later that month he appeared before the National Commission on Social Security to argue for his position. As he is both very knowledgeable and dedicated, I am both very confident and glad to be on the same side as George.

As we all know, individuals age 65 to 72 who qualify for full social security retirement benefits by virtue of their contributions to the social security fund during their earlier working years, but who continue to work and earn over $5000 annually, are currently subject to a substantial decrease in benefits of $1 for every $2 they earn over that limitation. (This is scheduled, under present law, to increase to $6000 in 1982, at which time the age limit will change to 65 through 69 years of age.) This practice is grossly unfair to our older population, as it puts an additional burden on their pursuit of employment and income, and thus discourages continued employment after age 65.

The primary objection to eliminating this restriction is the cost in additional social security benefits that would have to be paid. However, studies do suggest that much of what is lost through additional benefits would be recouped through the additional tax revenue that is generated.

According to an article which appeared in the "Social Security Bulletin" in September 1979, "Tax Impact From the Elimination of the Retirement Test," about 79 percent of the estimated increase in payments would be made up through additional revenues, such as social security taxes and individual income taxes, at an estimate of $1.7 billion, as compared to $2.1 billion in increased outlays. (This is based on the 1982 scheduled change in the earnings limitation criteria and assumes that an additional 10 percent of workers age 65 through 69 either fully retired or contemplating retirement would choose to continue full employment as a result of the elimination of this test.)

Another study on the subject by Professor Marshall Colberg of Florida State University (1978, American Enterprise Institute) estimates that additional savings would also be generated by the collection of more federal excise taxes, a decline in social security administrative costs since the test is awkward to administer, and less underreporting of earned income to the IRS. He has also suggested that increased participation in the workforce by individuals over age 65 would contribute to the overall economy. Needless to say, Professor Colberg believes the social security earnings test is wrong and should be eliminated.

I was pleased to see that the interim report by the President's Commission on Pension Policy has recommended that the earnings limitation test be removed, although I regret that they have made their recommendation conditional on the xation of social security benefits—a policy which this Congress is in the process of jecting.

It is generally acknowledged that social security is intended to supplement other urces of retirement income, such as pension benefits and personal savings, and e Commission's report suggests that income earned by older workers should also considered as another source. But as the report also points out, "the biggest sincentive to work within the context of the social security system is the retirement or earnings test." This disincentive has several important negative consequences. In terms of the economy, it means that we do not fully utilize the skills d experience that older workers developed over the years. It might also mean at an older person will be more likely to turn to the government for help in aintaining a decent standard of living. The Commission's report cites figures dicating that 14 percent of our retired population in 1977 were living in poverty. lany seniors work out of need and no doubt feel an increased pride in thus aintaining themselves without having to ask the government for help. While some ill argue that the earnings limitation merely restricts the level of earnings of orkers over age 65, as a January 30, 1970 Social Security Administration report oints out, an older worker "* * * may not, however, have control over the amount f his work. The choice facing him may be a job paying a certain amount or no job t all."

Attitudes toward retirement have also changed, and it's now realized that a orced, sudden, or complete retirement from work may be both physically and nentally detrimental. Congress recognized this in raising the mandatory age retirement to 70. We've realized that older workers still have a great deal to contribute, hat many want to continue to work, and that their own well-being and that of the ation can be improved by insuring that employment opportunities are available to hem. The earnings limitation test is simply contrary to this policy and works gainst the progress that has been made in eliminating age discrimination in mployment.

A particularly galling aspect of the retirement test is that it is only applied to arned income. There is no limit on the amount of unearned income that an ndividual may have and still receive their full social security retirement benefits. On the other hand, those who are over 65 and have paid into social security over he years, but who wish to continue working, not only must continue to pay into ocial security as well as pay income tax, but they also have the additional penalty of a reduction in benefits by 50 percent of whatever they earn over $5000 annually. It is senseless, especially in light of current economic problems, to reward the unproductive and slap the hands of those who wish to work.

Clearly, for the sound reasons of justice, economic productivity, and the benefits to the nation and the individual that would be derived from an increase in the number of older workers, the elimination of the retirement test for individuals over age 65 is long overdue.

Mr. **Burton**. I also wish to submit the prepared statement of our colleage, Congressman Herbert Harris of Virginia, because of his interest in this issue.

[The prepared statement of Representative Herbert E. Harris II follows:]

Prepared Statement of Representative Herbert E. Harris II

Mr. Chairman: I appreciate this opportunity to submit a statement to the House Subcommittee on Retirement Income and Employment and I want to commend you for scheduling hearings on one of the most important issues facing senior citizens today—the outside earnings limitations for Social Security recipients. I believe that the testimony presented to the Subcommittee will incite a groundswell of support for eliminating this inequity and, hopefully, legislative action will follow soon thereafter.

A recent report prepared by the National Commission on Social Security stated that, "Although more Americans look forward to retirement than do not, they tend to have some reservations about the quality of retirement life. Most people are more concerned about not having enough money than about having enough to do in retirement".

The fact that senior citizens have great anxiety over their future financial situation is not surprising and, in light of the current economic climate, very understandable. We all know that inflation works its most severe toll on those people living on fixed incomes and, despite the cost-of-living increases, millions of elderly people still find themselves rapidly losing ground to the rising costs of food, health care, energy and housing.

To help defray the increasing cost of living, many senior citizens have decided to go back to work. Besides being financially beneficial to the individual, our society as a whole benefits from their economic productivity. Senior citizens have talent and years of experience that contribute greatly to the American workforce and there is no rational reason why they should be discouraged from doing so. However, as we all know, current law does, in fact, discourage the elderly from going back to work and penalizes those who actually do go back. This is because Federal law requires that Social Security recipients return 50 percent of their outside earnings over $5,000 if they are between the age of 65 and 71. For those under 65, the deduction begins at $3,720. As you recall, these ceilings were recently raised from $4,500 and $3,480 respectively. However, this was only a minor step. The Congress needs to go even further.

As a co-sponsor of Representative Pepper's bill, H.R. 2570, I believe that the earnings limitation is wrong and should be repealed.

Mr. Chairman, the Congress takes many actions, the consequences of which are not immediately foreseeable. When the Congress imposed the outside earnings limitation, no one could have predicted the current 18 percent rate of inflation and its effect on senior citizens. This unforeseen circumstance is one simple reason for repealing this law.

There is another, more basic, reason for eliminating the outside earnings limitation. The senior citizens who have spent their lives building America have the right to live out their remaining years in dignity, without the fear of having to choose between staying warm, eating, living in decent housing, or receiving adequate health care. If a person wishes to make a little extra money to make life easier, he or she should be applauded for doing so—not penalized. All senior citizens should be able to collect the Social Security benefits that they earned for their hard work in the past, and they should be able to collect a full paycheck for the work they currently perform.

By discouraging senior citizens from working, we are forcing many of them into a life of quiet stagnation, ignoring the fact that they can still contribute to society. By imposing an earnings limitation, the talents of millions of elderly people are being withered away. I believe that the American economy needs senior citizens and the government should not discourage them from re-entering the workforce. The current law is wrong, unproductive and the Congress should take immediate action to see that it is repealed.

Mr. **Burton**. The first group of witnesses we have are a panel of concerned citizens: William O'Holleran, a concerned citizen who has been affected by the test; Prof. George Gibbs, emeritus professor at Claremont Men's College; and Tish Sommers, director, Older Women's League Educational Fund.

Tish, why don't you start.

PANEL OF CONCERNED INDIVIDUALS CONSISTING OF TISH SOMMERS, DIRECTOR, OLDER WOMEN'S LEAGUE EDUCATIONAL FUND, OAKLAND, CALIF.; PROF. GEORGE GIBBS, C.P.A., PH. D., EMERITUS PROFESSOR OF ACCOUNTANCY AND ECONOMICS, CLAREMONT MEN'S COLLEGE, CLAREMONT, CALIF.; AND WILLIAM J. O'HOLLERAN, CONCERNED CITIZEN, SILVER SPRING, MD.

STATEMENT OF TISH SOMMERS

Ms. **Sommers**. Distinguished members of the committee, my name is Tish Sommers, testifying in behalf of the Older Women's League Educational Fund, a nongovernmental body committed to the concerns of female citizens generally regarded as over-the-hill. This segment of the population is seldom considered when making public policy, but it should be, especially when designing legislation to deal with retirement income.

First, women comprise two-thirds of the retired population. Second, women's life expectancy is 8 years longer than men's, so

ales are dependent upon it longer. Third, far more elderly
nen than men rely solely on social security for survival. Only 1
of 6 have other pensions. Fourth, since 85 percent of surviving
uses are female, most women end up alone. And fifth, older
nen are the fastest growing segment of the elderly poor.

'or all these reasons it is quite appropriate that the impact of
legislative change affecting social security should consider
efully the impact upon this constituency. So thank you for the
ortunity to comment on the earnings test from the viewpoint of
er women.

'irst let me present a somewhat different perspective than the
al male point of view on retirement income. I feel that responsi-
ty, particularly since I am the only female testifying today.

Planners in this area use a metaphor to describe the optimum
irement situation. They speak of a three-legged stool, with social
urity, pensions and savings representing the legs. To have sound
irement, all three should be in place. Unfortunately for older
men the first leg is short and the second and third are usually
ssing. To prevent total collapse, a substitute has been fashioned.
fact, Supplemental Security Income is usually the women's leg
the retirement stool.

Why is this so? As often stated, social security is an earnings
placement system. Since most women work in the unpaid profes-
n of homemaker or in low paid traditional women's fields, bene-
s are correspondingly low. Further, private pensions offer an
stacle course for women and reward the long-term, steady
rker with low mobility and high earnings, usually male. These
cumstances are important to take into account, because sex
utral provisions in the law can have a discriminatory impact on
men.

Although the regulations may apply to both men and women
ually, they can affect women differently because predominant
rk patterns may differ widely. Since the Supeme Court tolerates
is type of sex discrimination, it is necessary to take a careful look
the impact on women when changes in the law are being consid-
ed.

Now, then, what is the significance of the retirement test to
der women? It is not a simple question since we must consider
e economic effect of removing the test or any liberalization.
bviously not all women would be affected equally, but since the
ost vulnerable and poorest group of older persons are women
one, we will examine the test from their point of view, and here
just one example, a widow, age 62.

She receives a monthly social security benefit of $224 per month,
$2,688 per year. With today's current inflated prices she can't
ve on that, and her meager assets put her above eligibility for
SI, nor is she old enough. Besides, she has no health coverage and
on't be eligible for medicare for another 3 years. So she has to go
work. That is no mean trick in itself for a 62-year-old woman
ng out of the job market.

But this woman has good clerical skills which are in demand,
nd fortunately for her she looks young. She can't take a half-time
ob because she needs health insurance, so she takes a full-time job
or $6,000 a year. Under 1980 regulations she will forfeit $1,140 per

year in social security. If she were 65 or older, she would forfeit only $500.

Pervading this material is the assumption of the intact couple. Yet, as pointed out, women on their own should be given special consideration in designing these laws. The impact on persons with lower benefits is greater, assuming the same annual earnings. If the annual benefits are $3,000, and you lose $2,000, that is harder than if your benefits are $6,000 and you lose $2,000. Since women typically receive lower benefits than men, the impact of these cuts is hardest on women.

What then should be done? In regard to the question asked by the subcommittee, "Does the current retirement test discourage work?" the answer would have to be, certainly not for the vast majority of older women, very few of whom are in the labor force, and even fewer are able to find jobs which pay much above the earnings limitation. The limit does, however, hit the widow between 60 and 65 and the divorced woman over 62 but under 65, especially since access to health care insurance is so closely tied to the full-time employment.

Also, these women, if they are able to get work, are usually struggling to build some kind of adequate retirement income for themselves. As we have been told over and over, social security was never intended to carry the full burden. Age and sex discrimination, no recent work experience, and obsolete skills and training all make the going rough.

A second part of the problem which must be addressed in any change is where is the money coming from? To answer the question of whether the retirement test is good or bad for older women depends in large part on whether the funding base remains constant, or whether liberalizations—this one or any other—can be financed from general revenues.

If in fact social security remains locked into payroll taxes, any liberalization, and certainly elimination of the retirement test, would probably come out of the hides of older women, especially dependents benefits. The proposed 1979 budgetary cuts are a case in point. Most would have had adverse impact on older women.

Fortunately, those proposed cuts were scrapped, thanks to this committee among others, but they indicate where future trimming may take place, especially if additional pressure is put on the system by elimination of the retirement test. Since nonworking older women alone are the poorest segment of the elderly population and are most dependent on social security, we oppose any nibbling away at dependents benefits. Therefore, we are concerned about elimination of the retirement test at the present time.

On the other hand, if general revenues are added to the social security funding base, that is another matter. It will always seem unfair that unearned income is not counted, but earned income can cut your benefits, all the explanations about the purpose of social security notwithstanding. To an older person who wants to work and overcomes all the obstacles to do so, this is just another example of age discrimination. To women who have worked all their lives without pay and get no benefits for it, who can't live on their dependent's benefits alone, and finally manage to land a job, it seems doubly unfair.

s older women, we have generally been left out when social
cy is in the making and we have not had an organized voice to
ak in our own interests. We plan to change that.
)ur rallying cry is—don't agonize, organize.
The prepared statement of Ms. Sommers follows:]

'REPARED STATEMENT OF TISH SOMMERS, DIRECTOR, OLDER WOMEN'S LEAGUE EDUCATIONAL FUND, OAKLAND, CALIF.

SOCIAL SECURITY EARNINGS TEST: IMPACT ON WOMEN

istinguished members of the Committee, my name is Tish Sommers, testifying in
alf of The Older Women's League Educational Fund, a non-governmental body
mitted to the concerns of female citizens generally regarded as over-the-hill.
s segment of the population is seldom considered when making public policy but
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ger. Third, far more elderly women than men rely solely on social security for
vival. Only one out of six have pensions. Fourth, since 85 percent of surviving
uses are female, more women end up alone. And fifth, older women on their own
the fastest growing segment of the elderly poor. Seventy-two percent of poor
erly persons are unmarried women. Two million women fall below the poverty
ex, and that measure notoriously understates the case. For all these reasons it is
te appropriate that the impact of any legislative change affecting social security
uld consider carefully the impact upon this constituency. So thank you for the
ortunity to comment on the earnings test from the viewpoint of older women.

efore considering the earnings test specifically, first let us present a somewhat
erent perspective than the usual male point of view on retirement income.
nners in this area use a metaphor to describe the optimum retirement situation.
ey speak of a three-legged stool, with social security, pensions and savings repre-
ting the legs. To have sound retirement, all three should be in place. Unfortu-
ely for older women, the first leg is short, and the second and third are usually
sing. To prevent total collapse, a substitute has been fashioned. In fact, Supple-
ntary Security Income (SSI) is the women's leg of the retirement stool.

Vhy is this so? As often stated, social security is an earnings replacement system.
ce most women work in the unpaid profession of homemaker or in low-paid
ditional women's fields, benefits are correspondingly low. Further, private pen-
ns offer an obstacle course for women and reward the long term, steady worker
h low mobility and high earnings. Women and low-paid men help subsidize the
nner's in the pension game. As long as existing provisions for pensions and social
urity benefits require attachment to paid employment, and as long as almost half
the women in the United States work without pay in the home, women are likely
face poverty in their retirement years.

Why are these circumstances important to take into account? Because "sex-
utral" provisions in the law can have a discriminatory "impact" on women.
though the regulations may apply to both men and women equally, they can
ect women differently because predominant work patterns may differ widely.
nce the Supreme Court tolerates this type of sex discrimination, it is necessary to
ke a careful look at the impact on women when changes in the law are being
nsidered.

The "offset provisions" in the 1977 Social Security Amendments are a case in
int. From the legislative history it would appear that the amendment to reduce
cial Security dollar for dollar for dependents of any recipient of a public pension
s aimed at the high riding double-dippers. But from our mail, it was the teachers,
vernment clerks and the rest of the large body of women working in lower paid
vernment jobs who were affected most by this offset.

Now, then, what is the significance of the retirement test to older women? It's not
simple question, since we must consider the economic effect of removing the test
any liberalization. Obviously not all women would be affected equally. But since
e most vulnerable and poorest group of older persons are women alone, we will
amine the test from their point of view. Here are three examples:

The first is a widow age 62. She receives a monthly social security benefit of $224
r month, or $2,688 per year. With today's current inflated prices she can't live on
at, and her meager assets put her above eligibility for SSI. Besides, she has no
ealth coverage and won't be eligible for Medicare for another three years. So she
s to go to work. That's no mean trick in itself for a 62 year old woman long out of
e job market. But this woman has good clerical skills which are in demand and

fortunately for her, she looks young. She can't take a half-time job because she needs health insurance, so she takes a full-time job for $6,000 a year. Under 1980 regulations, she will forfeit $1,140 per year in social security. If she were 65 or older, she would forfeit only $500.

The second example is a women divorced after a long marriage, who does not work. Her ex-husband receives a $300 monthly s.s. payment and she receives one-half that amount or $150. Both are over 65. He estimates his earned income for 1979 will be $10,000. It turns out that he earned $15,000, not one penny of which goes to her. But since there was overpayment, she ends up owing social security $883.

The third example is a couple, both over 65. He receives $300 per month and she gets $150 as his dependent wife, for a total social security payment of $450. He estimated his earnings for 1979 to be $7,500 for the year, but he earned more than that, or a total of $12,000. He dies in December of that year. Before the death benefit is paid, she learns there has been an overpayment of $1,995, which will be deducted from her widow's benefits at 25 percent per month. In other words, her $300 per month will be reduced to $225 for 26 months. Try to live on that!

These are of course isolated examples but there are certain points that should be examined which are not included in any of the material I have seen on retirement test. Pervading this material is the assumption of the intact couple. Yet, as pointed out, women on their own should be given special consideration in designing these laws. The impact on persons with lower benefits is greater, assuming the same annual earnings. If the annual benefits are $3,000, and you lose $2,000, that's harder than if your benefits are $6,000 and you lose $2,000.

With the same annual earnings, benefits for the worker with lower social security payment is cut by two-thirds, while those of the worker with higher benefits is cut only one-third. Since women typically receive lower benefits than men, the impact of these cuts is hardest on women.

Further, because women are usually treated as dependents under social security, they can be adversely affected by actions completely out of their control. The examples of the divorced woman and the widow, who ended up owing for overpayments because the estimated income had been exceeded by the wage earner may not be as common as other inequities, but they point out how vulnerable the dependency role makes older women.

What then should be done? In regard to the question asked by the Subcommittee, "Does the current retirement test discourage work?" the answer would have to be, certainly not for the vast majority of older women, very few of whom are in the labor force, and even fewer are able to find jobs which pay much above the earnings limitation. The limit does however hit the widow between 60 and 65 and the divorced woman over 62 but under 65, especially since access to health care insurance is so closely tied to full-time employment. Also, these women, if they are able to get work, are usually struggling to build some kind of adequate retirement income for themselves. As we have been told over and over, social security was never intended to carry the full burden. On the one hand, the uncertainty of dependents benefits is a strong disincentive for working in the home without pay, but on the other, the retirement test adds to the difficulties women experience in reentering the work force in later years. Age and sex discrimination, no recent work experience and obsolete skills and training all make the going rough.

A second part of the problem which must be addressed in any change is where is the money coming from? All discussion about social security, especially those related to equity for women, assume that the size of the pie cannot be changed, and that the task is to make the slices more equal. Therefore to answer the question of whether the retirement test is good or bad for older women depends in large part on whether the funding base remains constant, or whether liberalizations (this one or any other) can be financed from general revenues.

If in fact social security remains locked into payroll taxes, any liberalization, and certainly elimination of the retirement test, would probably come out of the hides of older women, especially dependents benefits. Take a look at the 1979 social security budgetary cuts recommended by the administration: eliminating the lump sum death benefit of $255 (remember surviving spouses are 85 percent women); eliminating the minimum benefits for low-wage workers (domestic workers, nursing home aides, home health care workers are the types of persons affected by such a cut); limiting the number of work years that may be disregarded in computing benefits (women have more years out of the labor force than men); eliminating benefits to a surviving parent when a minor child reaches age 16, and so forth. Fortunately these proposed cuts were scrapped, thanks to this Committee among others, but they indicate where future trimming may take place, especially if additional pressure is put on the system by elimination of the retirement test. Since older women alone by and large are the poorest segment of the elderly population and are most dependent on social security, we oppose any nibbling away at dependents benefits until an adequate substitute is in place. Therefore we are concerned about elimination of the retirement test at the present time.

On the other hand, if general revenues are added to the social security funding base that is another matter. It will always seem unfair that unearned income is not counted, but earned income can cut your benefits, all the explanations about the purpose of social security notwithstanding. To an older person, who wants to work and overcomes all the obstacles to doing so, this is just another example of age discrimination. To women who have worked all their lives without pay and get no benefits for it, who can't live on their dependent's benefits alone, and finally manage to land a job, it seems doubly unfair.

As older women we have generally been left out when social policy is in the making and we have not had an organized voice to speak in our own interests. We plan to change that. Last year OWLEF prepared a series of Gray Papers on "issues for action" by older women. (Copies have been made available to this sub-committee staff). This year we will launch the Older Women's League, a national membership organization of older women to advocate on such questions as social security, pension law, health insurance and employment opportunity. We will be forming chapters in all Congressional districts and you will be hearing much more from us. Our founding date is October 19th and we'll meet in Des Moines, Iowa. Our rallying cry: Don't agonize, organize!

Mr. **Burton**. Dr. Gibbs?

STATEMENT OF PROF. GEORGE GIBBS, C.P.A., PH. D.

Dr. **Gibbs**. Mr. Burton and members of the committee, in spite of last week's headline, "Social Security to be broke by 1982, Trustees Warn," I have come from California to suggest a change that would be equitable to millions of people.

I believe that the earnings test for retired people, now mostly those over 65 years of age, should be removed, not just sporadically modified. Some years the amount you can earn without penalty creeps up, but at a rate much less than inflation.

Why should nonworking citizens whose retirement income comes from dividends, interest, rentals, gambling, royalties and private pensions be treated better between the ages of 65 and 72 than those of us who have to continue to work?

Moreover, we are penalized by having to pay both social security and income taxes on our earnings and by losing 50 cents of every dollar due us in social security, if we should earn more than $5,000 in 1980.

Is this treatment fair and just or equitable, if you prefer that term? I realize that in 1982 the age will be reduced to 70, as the upper limit, but this is just tinkering with the law, not a basic change to bring about fair treatment.

There are no ceilings on the earnings of retired Congressmen, nor those of most government employees. Congressmen are scheduled to receive $29,000 per year pension, after 16 years in office, and can also earn all they want to. What about double dippers, such as retired military, police, and fire personnel who have both pensions and full-time jobs?

Since 1964, when I realized the unfairness of the earnings limitation for persons aged 65-72, I have sought to cure this inequity. I have found allies in both Houses of Congress, but not enough to be effective yet. Senator Church, chairman of the Special Committee on Aging, wrote that "Ideally speaking, I would prefer to see the earnings limitation abolished." Senator Goldwater thanked me for commenting on his "bill to repeal the earnings limitation." He had obtained several cosponsors, but not enough. My Congressman, Jim

Lloyd, introduced a bill to abolish the limitations. As recently as February 1979 he said, "We agree on the need to remove outside limitations." Our long-time friend, Congressman Lionel Van Deerlin, of San Diego, said, "Simple justice seems heavily on the side of no ceilings."

In a world crying for increased productivity we should encourage people to work. Former Secretary of the Treasury Simon said recently, "The only way to get out of inflation is to increase productivity."

No one has discussed the value of the increased productivity, if retirees were encouraged to be active in a world that needs many goods and services. As many of the retirees are producing unique goods and services, which they have developed, it is likely that no presently unemployed person would step in to fill their shoes. It has been argued that the social security system is basically a replacement of earnings and not a pension. The facts seem to dispute this argument.

Why reward the nonproductive person? I have clients with $30,000 to $35,000 annual unearned income, from not working, who also legally receive their social security. Is this equitable? An editorial in an American Association of Retired Persons Bulletin referred to this as follows: "To withhold benefits from older citizens who need to work to supplement inadequate income, while allowing full benefits to others with unlimited 'unearned income' is a gross inequity."

The additional revenue, by permitting those over 65 to work without limitations, has not been adequately studied. However, it has been estimated that it would cost less to pay everyone at age 65 than it does to enforce the income limitations, because of the massive paperwork involved in sorting citizens.

A recent research article, published by the Federal Government, estimates that about 79 percent of the cost of abolishing the earnings limitation would be recovered through taxes. The article assumed that 10 percent of the persons eligible to retire would continue to work. It is interesting to note that the same estimate of 10 percent was made by Mr. Robert M. Ball, former Commissioner of the Social Security Administration, in 1974.

In addition to the estimated 79 percent recovery, we should also estimate savings from the present cost of enforcing the present earnings limitations and the cost savings if an earnings limitation, of perhaps $10,000, were applied to all income, earned or unearned.

These figures would probably bring the total close to 100 percent. Therefore, eliminating the unfair earning limitation would shift no burden to other taxpayers.

Congressmen, poets, and just plain citizens have worked on this, but to no avail as yet. There has been no really concentrated effort to achieve equity, yet there is strong opposition from the bureaucrats and recently from the Social Security Advisory Council.

Their justification, that social security is not a pension, is hotly disputed, and reasonably so, by millions of Americans who had no legal choice but to contribute to the trust fund for more than 40 years. Equal contributions to a private pension plan would have produced retirement income with no earnings limitation.

Moreover, salaries could have been greater, throughout these 40 years, had employers not been required by law to contribute equal amounts.

In short, social security is not a gift. We pay premiums of 6.13 percent and our employers pay like premiums of 6.13 percent, from which we should receive the benefits.

There are many supporters who wish to eliminate the inequity of the earnings limitation outside of Congress. One of the most fervent is my neighbor, the humorist Richard Armour, who has just written his 53rd book.

My poet friend wrote "Owed"—not O-d-e but O-w-e-d—"to Social Security" 6 years ago.

If I should keep living till seventy-two,
Which males in my family never do,
Or maybe stop writing, thus sparing my editors
And pleasing, I'm certain, my many competitors,
I might for some months or a couple of years
Get back a small part, very small (I shed tears)
Of what I've paid in to this devilish plan
At the maximum rate since the year it began.
I've millionaire friends who because of the source
Of their income collect, while I cannot of course,
And some who quit work to collect but instead
Because of the boredom were very soon dead.
Oh, Social Security truly is senseless;
It feeds upon those who, like me, are defenseless.
My blood pressure's up and I'm on medication;
It's caused, I am told, by severest frustration,
Frustration provoked in this person of purity
By nothing, I swear, except Social Security.

Now Dr. Armour is over 72.

Thank you very much.

Mr. BURTON. Mr. O'Holleran?

STATEMENT OF WILLIAM J. O'HOLLERAN

Mr. O'HOLLERAN. Thank you, Mr. Chairman.

I am William O'Holleran, a client of the Over Sixty Counseling and Employment Service of Montgomery County Federation of Women's Clubs. My testimony is more on the personal side, since we have covered the financial aspects of the act.

I was born in Chicago on January 27, 1913. My education consists of 8 years grammar school, high school and assorted courses at collegelevel schools and the Art Institute of Chicago. I have been in the graphic arts since 1930. At the present time I am credit manager for an industrial TV company—CTL Televideo Communications.

My situation is unique. I have been a dialysis patient since March 1979. As a dialysis patient, I was advised by the staff at Georgetown Hospital to obtain a job as a therapeutic measure. It would need to be a job that required little effort since my energy span is short. It would appear to me that I should not be penalized by the means test that would limit my earnings. My earnings total approximately $5,500 per year plus approximately $7,800 per year for my wife and I from social security. I might add I am receiving disability payments from social security due to the fact I am on dialysis.

Since my wife is arthritic, it is necessary to obtain household help and special medication. In my case it is necessary to maintain a special diet as it applies to a dialysis patient.

My end stage renal failure was probably triggered by industrial pollution in Chicago at a large printing operation. I was employed in that plant for a total of 15 years. I changed employment several times, beginning in 1956. My most recent full-time employment was as a sales representative for a large chemical company. I was discharged by mutual consent since I refused a transfer to another city. None of the retirement benefits that accrued during the period 1956 to 1978 is of any benefit to me at this time.

I then enumerated my expenses. I won't go into the details here. It appears in my testimony.

It is my opinion that social security should not penalize anyone for having the ambition and knowledge to seek employment to the benefit of themselves and adding to the ability to pay taxes through purchases they would not ordinarily make under the means test now in operation.

Under the present system, I would need to either be penalized for attempting to make my own way or forego working and spend less and run the risk of serious psychological problems due to inability to work, as I have been advised to do.

I may add also that the limitation rule makes dishonest people out of a lot of honest people. In other words, it is entirely possible for someone say 65 to 70 to get a job, and the employer makes a special arrangement with him and says all right, I will pay you, but you will be a contractor, and I will just pay you per week for what you do, no deductions.

As a result, this employee has no protection under the workmen's compensation laws, as I understand it. He acquires no insurance protection while he is on the job. Nine times out of ten he will not report this income, which represents a good loss to the Government as far as taxes are concerned. It makes dishonest persons out of the employers, makes a dishonest person out of the employee.

Now, without the means test I think this could be wiped out. I think we would have a more honest approach to the retirement picture.

In closing, I would like to say that in my opinion the older worker is being accepted more and more by the employer as a reliable, conscientious employee.

I would like to to thank you all for your attention.

[The following material was submitted by Mr. O'Holleran.]

My personal expenses are as follows:	*Per month*
Rent	$350
Food	200
Wife's medication	30
Car expense	45
Expenses:	
Insurance (life, car, and furniture)	100
Incidentals	50
Total for necessities	725
Clothing	50

Entertainment	80
Household help	75
Total expenses per month	930
Total income	13,300
Expense	11,160
For emergencies, savings account per year	2,140

Mr. BURTON. Thank you very much, sir.

We have a vote on the floor. I would suggest we make the vote, and come back to hear from Congressman Goldwater, who will present his father's testimony. Then we can go into questions of the panel.

So, without objection, we will be in recess.

[A brief recess was taken.]

Mr. BURTON. The subcommittee will be back in session.

At this time I would like to yield to the distinguished chairman of the full Select Committee on Aging, an individual who has done more for the rights of the elderly in our Nation than anyone in its history, the Honorable Claude Pepper, Member of the Congress from Florida.

STATEMENT OF CHAIRMAN CLAUDE PEPPER

Mr. PEPPER. Thank you, Mr. Burton.

I would like to say also you have made a very great contribution to the elderly, since you have been the chairman of the subcommittee. We could not have accomplished what we have achieved without your own great help and contribution toward that achievement.

This is a very commendable hearing you are holding today, on one of the most critical subjects facing our country, and especially the 24 million of our citizens who are over 65 years of age, having to do with old age pensions, or social security and now particularly with the earnings limitation.

As almost all of the 30 million people aged 62 or older realize, current law strips away $1 in social security benefits for every $2 earned over the limit. This year, that limit is $3,700 for workers aged 62 to 64 and $5,000 for workers aged 65 to 72.

Next year the amount would be $5,500 that may be earned, without a reduction in the social security benefit and the following year it will be $6,000. Those are great improvements over I think $1,700 a year it was when we first began to work on it to try to improve the amount that elderly people could receive without having any reduction in that amount on account of what they earned.

When the social security program was enacted in 1935, the earnings limitation attracted scant attention. Life expectancy and inflation were at much lower levels than at present. A worker was expected to retire at age 65, if not sooner.

The current earnings test is predicated on the expectations of a bygone era. Today, Americans reaching the age of 65 can expect to live for 16½ more years. The average individual monthly social security benefit of $289 simply will not allow one to retire for that length of time.

In addition, fewer older people intend to spend 16 years in the rocking chair. Today, older Americans are demanding the right to stay on the job. With today's skyrocketing consumer prices, many older Americans have no choice but to stay on the job.

Given today's realities, it is simply unfair to say to an older worker, "All right, you can keep working, so long as you forfeit the social security benefits to which you have contributed all of your working life." It is unfair and it is bad social policy.

At the same time, Congress cannot ignore the cost of removing the test entirely. The latest round of payroll tax increases fell most heavily on the low- and middle-income workers, whose retirement security we are also concerned with.

The social security retirement program must be adapted to meet the needs of today's elderly population. I am hopeful that the distinguished panel of witnesses will offer recommendations to help social security meet that challenge.

If I may just state a personal view—which is of course not that of the committee, or of the subcommittee, necessarily, but a personal view—when one comes to be 65 years of age, who is covered by social security, that individual should be permitted to draw his or her full social security benefits, without any regard to what that individual may earn; that while drawing those benefits, the individual should be permitted to earn all he or she can.

If they feel they can let up a little bit from the stress that they have observed during a long working life, that is all right, they may do that, with the added little protection of the social security benefit, an average of $289 a month, and I think a maximum of $400 and something receivable.

I say if they want to let up a little bit and work part time, or share a job with somebody else, which they could do if they had the little nest egg of the social security benefit along with their earnings, well and good.

If they have demand in their family for more income—and today most elderly people need more income than they are receiving, because social security benefits are not adequate for their adequate sustenance. So, I know it will cost money.

Wilbur Mills used to say in the Rules Committee, when I would ask him about doing that, it would cost $2 to $2.5 billion a year. I still think it would be a justifiable expense, at least if the economy of this country was relatively in a normal state, if we didn't have some of the grave problems that we are facing right now in budget balancing.

So, I am hoping that you, Mr. Chairman, and your able committee from these distinguished witnesses that you will hear will be able to come up with something that the Congress can do that will make a better income available for elderly people, even if they do work, work to their utmost.

Thank you.

Mr. **Burton**. Thank you very much. I know you have to go to the Rules Committee. We appreciate your coming by.

We will now hear from Barry Goldwater, Jr., who will be presenting a statement by Senator Goldwater, one of the leaders in the fight to eliminate the earnings test.

Congressman, it is always a delight to have you before the committee.

STATEMENT OF HON. BARRY M. GOLDWATER, JR., A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. **Goldwater**. Thank you, Mr. Chairman.

Mr. Chairman, I didn't realize until just prior to coming to the committee that Senator Goldwater has been working on this particular problem of reforming the earnings test for almost 20 years now.

In fact, I understand that in 1964, when he ran for President of the United States, it was one of the planks in his platform adopted at that particular time. Over the years he has pursued this concern, resulting in an amendment to the 1977 Social Security Act that was adopted in the Senate, and then concurred with here in the House, that in fact raised the earning limitation to $6,000 by 1982, and increased the age from 65 to 70.

This effort on his part, along with many others, of course, who believed likewise, is an ongoing concern of his. I know at this point he could not be here personally to present this testimony, inasmuch as he is currently in the hospital for a minor overhaul. He asked me to present his paper, and I do so with a great deal of pleasure.

I would also like to present to the committee his senior legislative analysis, Terry Emerson, sitting on my right. He has been working on this issue with him.

Mr. Chairman, I welcome the opportunity to present this statement from Senator Goldwater:

> First, I want to commend you and this committee for the great leadership you have shown in achieving passage of the Age Discrimination Amendments of 1978, which prohibit mandatory retirement before age 70. I hope you will have equal success in reforming the earnings ceiling.
>
> Mr. Chairman, I believe the earnings test should be repealed at age 65, the traditional age of entitlement to full Social Security benefits.
>
> A bill I have introduced in the Senate, with 19 co-sponsors, will do just that. S. 1287 will repeal the earnings ceiling for all persons age 65 and older, beginning in January of 1983.
>
> Mr. Chairman, the law now discriminates against more than 11 million citizens aged 65 to 72. If persons of this age continue working, they pay a tax of 50 percent. They lose $1 of benefits for each $2 of wages on all income earned over $5,000, until their benefits stop entirely.
>
> In the words of Professor Carolyn Shaw Bell, Chairperson of the Department of Economics at Wellesley College, "What emerges here is a pattern of systematic discrimination against people in this particular seven year span of their lives."
>
> This penalty is in addition to any federal, state, county and city income taxes they will have to pay on their earnings, and it is on top of Social Security payroll taxes which aged workers must pay, even if they lose all their benefits.
>
> Mr. Chairman, I have said many times, and I repeat it today, the money older persons pay into Social Security is theirs. It does not belong to the government. The government's only responsibility is to pay it back.
>
> Now, I will turn to the question of cost. The Office of Actuary at the Social Security Administration estimates it will cost $2.1 billion to repeal the test in 1983 for older persons.
>
> Now, if you do not ask the right question, the agency will give a much higher estimate. For example, if you simply ask them how much it costs to repeal the earnings test, the officials will tell you $6 or $7 billion. That is because they will lump together older persons with some 11 million young beneficiaries, such as college age dependents.
>
> If you narrow down your question to ask how much it will cost to eliminate the test only for persons 65 and older, they will answer $2.8 billion. That is the estimate for 1980, before the exempt age falls to 70 from 72.
>
> But if you focus your question on my bill, which calls for repeal at age 65 starting in 1983, then you would be given the estimate of $2.1 billion.

Now, please note this is the cost before any offsets are considered. A recent Social Security Administration study finds that there will be at least $1.7 billion of revenue offsets if the ceiling is eliminated. This means the net cost of my bill, using the Social Security Administration's own data, is $400 million, not the several billions of dollars you see bandied about in erroneous newspaper reports.

A recent study by Social Security Administration researchers concludes that, if the earnings test were eliminated for workers aged 65–69, the net increase in Social Security taxes and income taxes will amount to 79 percent of the cost.

This study was published last September in the official Social Security Bulletin. It finds that recipients aged 65–69, who are presently working, will increase their earnings enough to raise an additional $139 million of Social Security taxes and $191 million of income taxes. The researchers find that 1,373,000 older persons already working will add to their earnings if the ceiling is removed.

The Social Security researchers also believe 299,000 persons aged 65 to 69, who will otherwise by fully retired, will rejoin the work force if the earnings test is eliminated. These workers will generate an additional $540 million of Social Security taxes and $786 million of income taxes.

In all, the study finds that repeal will bring in nearly $1.7 billion of new revenues.

Since 80 percent of the new tax revenues will come from earnings of retired persons who return to work, I will take a closer look at this group. The Social Security Administration researchers believe that only 5 percent of all retired recipients aged 65 to 69 will re-enter the work force. The researchers estimate there will be a total of 5.7 million retired workers in this age group, but the Social Security actuary estimates there will be 7.6 million fully retired persons 65 to 69 in 1983.

Mr. Chairman, I believe a much larger percentage of retired persons will return to work if the earnings test is eliminated. For example, if the researchers had applied their estimates to 7.6 million retired persons, the number given by the Office of Actuary, they would have found that 395,000 persons will return to work with earnings above the former ceiling. Just this one change in their calculations would have brought the offsets into balance with the cost of repeal.

Also, I would call your attention to a study by the Social Security Administration in 1978 that finds 12 percent of all retirees would return to work. and another 24 percent may return to work, if given the inducement to do so. This is up to 36 percent of all retirees.

Consistent with this conclusion is a recent report prepared for the National Commission on Social Security, which finds that four in ten people would postpone retirement until age 70 if they could receive significantly higher benefits as a result.

Mr. Chairman, I urge you to give older persons a break. Repeal the earnings test and remove this robbery of older persons.

Mr. Chairman, I would like, if I may, to ask unanimous consent that Senator Goldwater's entire statement and supporting documentation, which has been put together by Mr. Emerson, be included in your record.

Mr. Burton. Without objection.

[Senator Goldwater's prepared statement and attachment follow:]

PREPARED STATEMENT OF SENATOR BARRY GOLDWATER

THE LAW THAT ROBS OLDER PERSONS

Mr. Chairman, I welcome the opportunity to present this statement.

First, I want to commend you and this Committee for the great leadership you have shown in achieving passage of the Age Discrimination Amendments of 1978, which prohibit mandatory retirement before age 70. I hope you will have equal success in reforming the earnings ceiling.

Mr. Chairman, I believe the earnings test should be repealed at age 65, the traditional age of entitlement to full Social Security Benefits.

A bill I have introduced in the Senate, with nineteen cosponsors, will do just that. S. 1287 will repeal the earnings ceiling for all persons age 65 and older, beginning in January of 1983.

Mr. Chairman, the law now discriminates against more than 11 million citizens aged 65 to 72. If persons of this age continue working, they pay a tax of 50 percent! They lose one dollar of benefits for each two dollars of wages on all income earned over $5,000, until their benefits stop entirely.

In the words of Professor Carolyn Shaw Bell, Chairperson of the Department of
onomics at Wellesley College: "What emerges here is a pattern of systematic
scrimination against people in this particular seven year span of their lives." [1]

This penalty is in addition to any federal, state, county and city income taxes they
ll have to pay on their earnings; and it is on top of social security payroll taxes
hich aged workers must pay, even if they lose all their benefits.

There have been changes in the law. Under a 1977 amendment, the ceiling will be
creased in stages from $3,000 to $6,000 and the exempt age will fall from 72 to 70,
fective in 1982.

Even with these changes, however, the total number of persons 65 to 70, who will
subject to the ceiling in 1982, will exceed 10 million.[2]

Thus, my bill provides that a year after the already scheduled increases end, the
xempt age will become 65.

Mr. Chairman, I have said many times, and I repeat it today, the money older
ersons pay into social security is theirs. It does not belong to the government. The
overnment's only responsibility is to pay it back.

It is the working person who bears the entire burden of paying the social security
ax. Professor William C. Mitchell of the University of Oregon has written: "What-
ver the fiscal illusions involved, the tax on the employer is actually a tax on labor;
e passes on his share of the tax to workers in the form of lower wages."[3]

There are other reasons for repealing the wage test. The American Medical
ssociation has concluded that older persons, who are forced to retire prematurely,
uffer tremendous physical and mental harm.[4] Another reason is the heavy drain on
he national economy caused by loss of the skills and production of older persons.

Moreover, I would point to the inconsistency between the Age Discrimination Act,
which bars the mandatory retirement of a person before age 70 and the Social
Security Law, which penalizes persons for working after age 65. What the Govern-
nent gives with one hand, it takes away with the other.

Now, I will turn to the question of cost. The Office of Actuary at the Social
Security Administration estimates it will cost $2.1 billion to repeal the test in 1983
or older persons.[5]

Now, if you do not ask the right question, the agency will give a much higher
estimate. For example, if you simply ask them how much it costs to repeal the
earnings test, the officials will tell you six or seven billion dollars. That is because
they will lump together older persons with some 11 million young beneficiaries,
such as college age dependents.[6]

If you narrow down your question to how much it will cost to eliminate the test
only for persons 65 and older, they will answer $2.8 billion. That is the estimate for
1980, before the exempt age falls to 70 from 72.

But, if you focus your question on my bill, which calls for repeal at age 65 starting
in 1983, then you would be given the estimate of $2.1 billion.

Now, please note this is the cost before any offsets are considered. A recent Social
Security Administration study finds that there will be at least $1.7 billion of
revenue offsets if the ceiling is eliminated.[7]

This means the net cost of my bill, using strictly data out of the Social Security
Administration, is $400 million, not the several billions of dollars you see bandied
about in erroneous newspaper reports.

Now, I would like to look more closely at the cost offsets, so you can understand
exactly where they will come from.

Professor Marshall Colbert of Florida State University, a former President of the
Southern Economic Association, had identified at least five important savings that
will result from repeal of the earnings test. He writes:

"1. Added income tax collections would accure from additional earned dollar
income as a result of expansion of labor force participation of OASI recipients.

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[1] Dr. C. S. Bell, "The Cruel Tangled Web Called Social Security," Los Angeles Times, Dec. 16, 1973, part VI, at pp. 1, 4.

[2] See memo from Office of Chief Actuary, Social Security Administration, to Senator Barry Goldwater, dated Apr. 28, 1980, appendix I.

[3] W. Mitchell, "The Popularity of Social Security: A Paradox in Public Choice," American Enterprise Institute for Public Policy Research, 1977, at p. 8.

[4] See "Retirement: A Medical Philosophy and Approach," American Medical Association Committee on Aging, 1972, at pp. 1–3.

[5] See memo from Office of Chief Actuary, Social Security Administration, dated July 5, 1979, appendix II.

[6] The under-65 age group includes 3,000,000 spouses of retired workers, 700,000 children of retired workers, and 7,600,000 survivors of diseased workers. Source: Office of the Actuary, Social Security Administration.

[7] Josephine Gordon and Robert Schoeplein, "Tax Impact From Elimination of the Retirement Test," Social Security Bulletin, vol. 42, Sept. 1979, at pp. 22–32. See appendix III.

"2. Additional payroll tax collections would be made from the added employees and their employers, and from self-employed recipients of old-age benefits.

"3. More federal excise taxes would be collected.

"4. Underreporting of earned income to the Internal Revenue Service should decline.

"5. A decline in Social Security Administration costs would occur since the earnings test is hard to administer." [8]

Professor Colberg adds a sixth factor in recent testimony before the Senate Special Committee on the Aging. He says: "The whole idea of the cost of repeal of the retirement test is a fallacy based on a narrow accounting view. Extra work effort by the over-65 group would increase the real national product and real income per capita." [9]

Professor Colberg's findings are confirmed by Professor Colin D. Campbell, who is Professor of Economics at Dartmouth College and one of the nation's leading authorities on social security.

In a private letter to me, dated September 17, 1979, Professor Campbell writes: "From the point of view of the economy, the retirement test is clearly a bad policy. It discourages employment, reduces the supply of labor, and lowers the total output of the economy." [10]

Professor Colberg estimates that removal of the earnings ceiling will raise at least $633 million additional payroll and income taxes from retired workers who now draw their full benefits, but will return to work if the wage test is repealed. Since they already receive full benefits, they will not cost the system any additional money. The Colberg study does not include any older persons who already work and may increase their incomes once the ceiling is lifted. [11]

A recent study by Social Security Administration researchers covers both groups of older persons, those who are presently retired and those who are still working. This new study concludes that if the earnings test were eliminated for workers aged 65–69, as provided in my bill, the net increase in social security taxes and income taxes will amount to 79 percent of the cost. [12]

This study was published last September in the offical Social Security Bulletin. It finds that recipients aged 65–69, who are presently working, will increase their earnings enough to raise an additional $139 million of social security taxes and $191 million of income taxes. The researchers find that 1,373,000 older persons already working will add to their earnings if the ceiling is removed.[13]

The Social Security researchers also believe 299,000 persons aged 65–69, who will otherwise be fully retired, will rejoin the work force if the earnings test is eliminated. These workers will generate an additional $540 million of social security taxes and $786 million of income taxes. [14]

In all, the study finds that repeal will bring in nearly $1.7 billion of new revenues.

Since 80 percent of the new tax revenues will come from earnings of retired persons who return to work, I will take a closer look at this group. The Social Security Administration researchers believe that only 5 percent of all retired recipients aged 65-69 will reenter the work force. The researchers estimate there will be a total of 5.7 million retired workers in this age group,[15] but the Social Security Actuary estimates there will be 7.6 million fully retired persons 65 to 69 in 1983.[16]

Mr. Chairman, I believe a much larger percentage of retired persons will return to work if the earnings test is eliminated. For example, if the researchers had applied their estimates to 7.6 million retired persons, the number given by the Office of Actuary, they would have found that 395,200 persons will return to work with earnings above the former ceiling. Just this one change in their calculations would have brought the offsets into balance with the cost of repeal.

Also, I would call your attention to a study by the Social Security Administration in 1978 that finds 12 percent of all retirees would return to work, and another 24 ent may return to work, if given the inducement to do so.[17] This is up to 36 ent of all retirees.

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[8] M. Colberg, "The Social Security Retirement Test; Right or Wrong?" American Enterprise Institute for Public Policy Research, 1978, at pp. 42–43.

[9] Testimony of M. Colberg before the Senate Special Committee on Aging, Nov. 28, 1979.

[10] See also, C. Campbell-R. Campbell, "Conflicting Views on the Effect of Old-Age and Survivors Insurance on Retirement," Economic Inquiry, vol. 14, Sept. 1976, at pp. 269, 385; C. Campbell, "The 1977 Amendments to the Social Security Act," American Enterprise Institute for Public Policy Research, 1978, at p. 18.

[11] See letter from Dr. M. Colberg to Senator Barry Goldwater, dated Sept. 12, 1979, appendix IV.

[12] Gordon-Schoeplein, note 7 supra at 30.

[13] Id. at 26.

[14] Id. at 29.

[15] Id. at 26.

[16] See appendix I.

nsistent with this conclusion is a recent report prepared for The National mission on Social Security, which finds that four in ten people would postpone rement until age 70 if they could receive significant higher benefits as a result.[18]

r. Chairman, I urge you to give older persons a break. Repeal the earnings test remove this robbery of older persons.[19]

See appendix 3, p. 160 for attachments to Senator Goldwater's pared statement.]

Mr. **Burton**. Thank you very much, Congressman.

have just one question of you before we go to the panel.

Does Senator Goldwater's bill make any provision for getting ne of the projected increases in income tax revenues back into trust fund to make up more of the $2.1 billion cost?

Mr. **Goldwater**. If I could refer to Mr. Emerson, I would like to ve him respond.

Mr. **Emerson**. Mr. Chairman, no, the bill does not include that. adopts that assumption. It would allow the committees on both es of the Hill to adopt whatever financing arrangements they nt.

Senator Goldwater has stated if the economic assumptions are ong, then he is willing to make other arrangements, financing rangements, to put the money into the system in order to finance is change. He would not allow the system to be damaged, in case ese calculations should turn out to be erroneous.

But as the Congressman expressed in his testimony, the estiates have been very conservative, very conservative on their nancial statistics.

Mr. **Burton**. Thank you very much.

Questions of the panel?

Ms. **Ferraro**. Yes.

I don't know if the committee is aware of the fact that Tish ommers really has done quite a bit of work in identifying and naming the displaced homemaker and has really moved ahead and has become quite a force in moving for the betterment of the woman who is going back into the work force.

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[17] D. Motley, "Availability of Retired Persons for Work: Findings from the Retirement History udy," Social Security Bulletin, April 1978, at p. 27.

[18] "A Nationwide Survey of Attitudes Toward Social Security," by Peter D. Hart Research sociates, Inc., at p. 15 (1980).

[19] Modern literature addressing the earnings ceiling is virtually unanimous in finding that moval of the wage test will increase labor supply substantially.

Profs. William Bowen and Aldrich Finegan point to the earnings test as the cause of up to alf of retirement decisions at age 65. W. Bowen and T. A. Finegan, "The Economics of Labor orce Participation," Princeton University Press, 1969, at pp. 281–285.

Prof. Michael Boskin of Stanford University finds the earnings test "dramatically increases e probability of retirement." He concludes that a mere reduction "of the implicit tax on arnings from one-half to one-third cuts the annual probability of retirement in half for typical orkers." M. Boskin, "Social Security and Retirement Decisions," Economic Inquiry, vol. 15, n. 1977, at p. 13.

Profs. Robert Kaplan and Arnold Weber of Carnegie-Mellon University argue that past overnment cost estimates have failed to consider millions of retired persons who would reenter e work force once the earnings test is repealed. R. Kaplan and A. Weber, "A Proposal to liminate the Social Security Retirement Test," Social Security Administration (working paper r the Advisory Council on Social Security), Sept. 1974.

Prof. Anthony Pellechio believes the proven clustering of earned income around the exempt mount, and the shifting of this cluster in step with each change in the exempt amount, present raphic evidence of the relationship between labor activity and the earnings ceiling. A. Pellehio, "The Social Security Earnings Test, Labor Supply Distortions and Foregone Payroll Tax levenue," National Bureau of Economic Research, Aug. 1978, at pp. 2, 5; also see testimony of rofessor Pellechio before U.S. Senate Committee on Finance, hearings on S. 1287, and other ills, Apr. 21, 1980.

The same results were found by Social Security Administration researcher Kenneth Sander in 970. Mr. Sander concluded that "a fairly large number of workers responded to the higher nnual exempt amount by increasing their annual earnings" to the new, higher ceiling. K. ander, "The Effects of the 1966 Retirement Test Changes on the Earnings of Workers Aged 65-2" Research and Statistics Note, Social Security Administration, Jan. 30, 1970, at p. 2.

In addition, the Older Women's League Educational Fund just received a White House grant for a miniconference. I am delighted that you did receive that.

Ms. SOMMERS. Thank you very much.

Ms. FERRARO. I have a follow up question for Mr. Emerson. Are you saying that the Senator then would support putting into the trust fund of moneys from the general revenues in order to support this?

Mr. EMERSON. Actually what he would prefer is the opposite, but he would go along with whatever the committees that have the technical expertise finally decide.

His preference is to allow the gained money that is put into the general revenues to finance what he calls the welfare component of social security. That is the weighed, the skewed benefit that is higher than a recipient would get if that recipient's benefits were determined strictly on an actuarial basis.

The lower income recipients and workers receive a higher social security benefit, as you know, than is actuarially supported. Senator Goldwater would be willing to have that part shifted over, that part of the social security benefits system, shifted over to general revenues.

That is one concept he has that some private economists have suggested to him—have the part of social security benefits which are based on an actuarial basis, financed from payroll taxes. Have the other part of social security benefits that are what you might call a social benefit financed out of general revenues. But he would defer to the judgment of the technical committees.

Ms. FERRARO. But you are agreeing the way it stands now, the trust fund could not support elimination of the test?

Mr. EMERSON. Well, we would not agree with that. We say that we have taken into account that possibility. But under the careful documentation that has been presented to this committee, the evidence is that the offsets will balance the cost.

Ms. FERRARO. I may be reading the study a little bit differently than you. According to the estimates I have, it would cost $2.1 billion if we eliminated the test for those 65 and over. It is indicated we would get $1.7 billion in additional income and social security taxes. But that would be a total thing.

Only one-third of the $2 billion would go back into social security. So therefore your trust fund, which is already having its problems, would have much more of a problem.

Mr. EMERSON. Then you would have to make some——

Ms. FERRARO. Then you would have to go into general revenues.

Mr. EMERSON. That is correct.

Ms. FERRARO. I think that supports what you are saying as well, that there is currently a problem with the system. In order to make one side benefit a bit more—and there are inequities, I agree—we have to be practical, that we don't knock out those people who are receiving social security under the system and who might suffer quite a bit more.

Do you want to add something?

Ms. SOMMERS. Well, I think, as I said in the testimony, that there no question about the justice of elimination of the retirement t. But on the other hand, when it comes to how it is going to be anced, that is the practical bread and butter matter.

So many older women are completely dependent upon those nefits. The pressure seems to be to eliminate dependent benefits. I would much rather see the money go into some of the bills at Representative Oakar is supporting, particularly to address e very severe problem of the older woman.

Ms. FERRARO. I do raise that in my opening statement, which we ve already indicated would be placed in the record. In the inter- t of time, I would thank the panel for your testimony, and presentative Barry Goldwater, on behalf of your father.

Mr. BURTON. Ms. Oakar?

Ms. OAKAR. Thank you, Mr. Chairman.

Mr. Chairman, with your indulgence, I briefly would like to state hat my position is on this issue. I really support the elimination the earnings test for a couple of reasons.

One reason really is that while it is true that the Social Security ct was devised initially as a supplemental source of income, the ct is that it is not.

It is regarded as a pension by millions of Americans, as some eople have indicated. When we look at women, for example, who t an average benefit of $243.50 a month—and if they have taken n earlier pension, they get about $186.90—for most of these eople, that is their only source of income.

Unfortunately, they are penalized by the system because they annot go out and get a job even though they have some problems etting jobs. Some of them could get a job, but they are concerned bout that limitation.

The other thing is—and this should be of real concern to this ommittee—we fought very, very hard to end mandatory retire- nent, forced retirement before age 70. The present law removes he earnings test for individuals 72 and over. That is completely gainst the spirit of what this committee tried to do.

So, I just wanted to make my position very, very clear, and ask maybe just one quick question.

Mr. BURTON. Go ahead.

Ms. OAKAR. Mr. Gibbs, you mentioned something that I thought was very, very important. This is something that we are seeing. I am on this National Commission on Unemployment Compensation. We have studied the problems with that system, and what has evolved.

What you have said with respect to making dishonest people out of some individuals who otherwise would not want to go that route s very, very true.

Dr. GIBBS. That was Mr. O'Holleran. I would agree with him.

Ms. OAKAR. I am sorry.

Do you actually know people who have had that experience, whereby they——

Mr. O'HOLLERAN. Oh, yes.

Ms. OAKAR. And you know employers who have said we will slip you this amount of money?

Mr. O'Holleran. They enter into this agreement very rapidly. They love it.

Ms. Oakar. So what happens is, if that person loses a job, they cannot collect unemployment compensation, which is a very important benefit for the person who is laid off. The older people, like women and minorities, are the first ones to go. So, I really think that is an important point.

The other thing is, while I don't agree with your father on some other issues, I have to say that he has been squarely on the right side in this issue. I thought his testimony—the left side, maybe I should say—but I want to really commend you.

I would love to have a copy of your testimony and the documentation, Barry. I hope we can get that. Really, I think that is just tremendous.

Thank you, Mr. Chairman.

Mr. Burton. Mr. Green?

Mr. Green. I would like to address a question to Ms. Sommers.

You indicated that it is unfair that unearned income is not counted for purposes of the earnings test. I can certainly see the equities. On the other hand, if we were to count it, we would certainly be upsetting the retirement expectations of a lot of people who have been planning their retirement based on the assumption that they would have some unearned income, plus the social security benefits.

Do you think it would be fair to change the rules of the game on them suddenly?

Ms. Sommers. Well, older women have had the experience of having the rules of the game changed so drastically, because they assumed when they were married that their income and support would come through their marriage, and then found out that with the change in the divorce laws, the whole ball game has changed.

As far as the question of plans for the future, I think this we have to be very careful not to change the expectations of people. The offset, the experience with the offset, is a very good example of that. People have planned to have that supplementary retirement. When that was cut out, it was just disastrous for many older women.

Mr. Green. I have certainly heard many complaints from my constituents on that.

That is all I have.

Dr. Gibbs. What about a lady with a $700,000 estate, and she got her social security, as far back as I can remember. I did her taxes at least 15 years. Is that equitable? She didn't use her social security to plan anything. I know where her estate came from. Most of it was inherited from her folks.

Mr. Green. I guess a much more typical situation is someone where there is modest savings, you are drawing interest, and the person hopes to maintain a standard of life somewhat similar to that they previously enjoyed on the basis of what they have saved plus the social security.

If you are now going to knock out the social security part of that because they saved, it seems to me to do that on short notice at least would be most unfair.

Dr. GIBBS. I suggest a limit of $10,000. Maybe you could make it $15,000. Make the limit high enough so it wouldn't hurt anybody's planning, but still get all income treated alike.

Mr. BURTON. Mr. Evans?

Mr. EVANS. Thank you, Mr. Chairman.

I would like to express my appreciation to the witnesses who are here with us today. I, too, am very interested in this subject, and have been for a number of years.

One question I have for Mr. Gibbs. I believe in your testimony you argued for eliminating the retirement earnings test for those individuals 65 and over. Would you treat those differently than beneficiaries under age 65?

Dr. GIBBS. Maybe I have not studied the law enough. I did not worry about the people from 62 to 65 because I figured in most corporations, and most companies 65 has been a retirement age for a good many years. I just haven't discussed 62 to 65. I really don't know.

Mr. EVANS. I see. OK, fine, thank you.

Thank you, Mr. Chairman.

Mr. BURTON. Mr. Lloyd?

Mr. LLOYD. Thank you very much, Mr. Chairman.

I was going to give testimony, but it has been more than adequately addressed.

As my friend, adviser, and associate, Mr George Gibbs, who is here today, has indicated to you, I do have a bill similar to Senator Barry Goldwater's which addresses this issue.

I have lived through the problems of the elderly and earnings with my own mother-in-law, who passed away this last year.

I watched her frustration and irritation in trying to maintain her own dignity by living by herself and not asking either myself or my wife to participate, even though we really did.

I think this is a very important social function, the maintenance of dignity for older people. If people can maintain themselves after the age of 65, they are infinitely more productive, personally, and to the total of society.

Something that I think this committee ought to reflect on is the psychological impact of having someone who is elderly in the family who has the ability to be independent. The happiness of the total family is immeasurably improved in this case, and if we take that away, and that is precisely what we are doing, let me tell you, I don't care whether you are 25 or 15 or 35—you are going to be impacted by this. It reflects on the total family.

I think this is one of the reasons why we must go forward and readjust, this law so it provides for all of these kinds of involvements.

Oftentimes we talk about—and I have heard it here today—the money. Money is not really the main factor. The important point is that money is a function of independence for the elderly. That is what we are really concerned with.

I think that this committee, through these bills that are presented, has an opportunity to treat equitably what I consider to be an important social involvement for the elderly.

Thank you very much, Mr. Chairman.

Mr. Burton. I would just like to ask a question of each of the witnesses.

Based on the potential cost to the trust fund revenues and considering the recouping of revenues—probably about 70 percent of which would go into the general fund—do you support the transfer of general fund revenues into the trust fund to pay for the elimination of the earnings test?

Ms. Sommers. Absolutely.

Mr. Burton. Dr. Gibbs?

Dr. Gibbs. Yes, I would.

Mr. Burton. Mr. O'Holleran?

Mr. O'Holleran. Yes, I would.

Mr. Burton. All right, thank you very much, Tish, gentlemen, Congressman. Thank you very much for your testimony. Congressman, we wish your father a speedy recovery.

The next witness is Lawrence Thompson, Associate Commissioner for Policy, Social Security Administration.

Mr. Thompson.

STATEMENT OF LAWRENCE H. THOMPSON, ASSOCIATE COMMISSIONER FOR POLICY, SOCIAL SECURITY ADMINISTRATION, ACCOMPANIED BY ROBERT SCHOEPLEIN, OFFICE OF RESEARCH AND STATISTICS

Mr. Thompson. Thank you, Mr. Chairman.

With me this morning is Robert Schoeplein, who is with our Office of Research and Statistics, and is the coauthor of the article "Tax Impact From Elimination of the Retirement Test" that appeared in the Social Security Bulletin of September 1979, which has caused quite a bit of comment in front of this committee.

I have a prepared statement. With your permission, I would like to have it entered in the record.

Mr. Burton. Without objection.

Mr. Thompson. I will only read parts of it.

Mr. Chairman and members of the subcommittee, it is a pleasure to be invited to testify before this subcommittee and to have the opportunity to discuss one of the most controversial features of the social security program—the social security earnings test.

The social security program has always had an earnings test, although the way in which it has been applied has varied over the years. Under the original Social Security Act of 1935, no benefits were to be paid for any month in which a beneficiary had any earnings whatsoever in employment covered by social security. However, before the first monthly benefits were paid in 1940, the test was changed to provide that benefits would only be withheld for months in which covered earnings were $15 or more.

The earnings test has been modified several times since the 1940's to: allow greater supplementation of social security benefits with earnings; provide that benefits would be reduced more gradually as earnings levels increased; convert the test from a monthly test to an annual one; and broaden the scope of earnings countable under the test.

Social security has always been viewed as an earnings replacement program. Workers and their dependents are insured against the risk of earnings loss as a result of retirement, disability or death and benefits are designed to partially replace the earnings that are actually lost.

Private pension plans almost always require the person to stop working in employment covered by the plan as a condition for eligibility for their benefit payments; multi-firm plans generally require that workers leave the entire industry.

If social security were structured like most private pension plans, people would be required to cease all work in employment covered by social security in order to qualify for social security benefits. As I noted earlier, this was the arrangement contemplated for social security in 1935, but never actually put into effect.

There is in the way the earnings test is presently structured, however, a recognition of other important program or social goals. As a result, the test is now structured so that the principle that benefits should be paid only to those whose covered work income has ceased is balanced against principles that reflect at least three other goals.

The first goal is to allow people to supplement their social security benefits through a limited amount of earnings. This may be especially important for many lower income workers who do not have income from pensions or savings in addition to their social security benefits. It is sometimes said that "work is the poor man's pension."

The second goal is to preserve incentive and opportunity to work among the aged, and to assure the aged who do work that they will be better off financially as a result of their work effort.

The third goal is to provide that those who work well past the normal retirement age will get something back for the social security taxes they have paid.

Let me discuss how the earnings test represents a balancing of competing objectives.

First, the very existence of the earnings test reflects a desire to restrict payments to those who have retired. This is similar to the objective served in private pension plans when they require the individual to cease working in employment covered by the pension system.

Second, the fact that we establish an amount that a person can earn each year without any loss of social security benefits allows all beneficiaries some room to supplement their benefits with earnings without any penalty.

Third, both the exempt amount and the $1 for $2 withholding rate for earnings over the exempt amount guarantees that people are better off financially if they work. This preserves the fairness of the system and enhances work incentives.

Finally, having an upper age limit at which the earnings test no longer applies—72 at present, 70 by 1982—allows people who may never retire—for example, some farmers and other self-employed people—to obtain a decent return for participating in the program.

No compromise is ever perfect, but we believe that the effect of the present provisions is a reasonable balancing of diverse and, in some cases, conflicting goals. I should also note that the net effect of these provisions is that the present test affects far fewer people and affects them far less dramatically than is sometimes realized.

For example, in 1980 for a person who always had earnings equal to the national average, benefits are totally withheld only if earnings are above $16,725; for a person who always had earnings at the maximum level covered by social security, benefits are totally withheld only if earnings are above $19,874.

Some people argue that the earnings test should be eliminated totally, at least at age 65. They argue that workers have paid for their social security benefits through the payroll tax payments they and their employers have made over the years and that they should receive benefits at age 65 regardless of continued work or earnings.

They also argue that eliminating the test would further encourage work among the aged and produce additional payroll tax and Federal income tax revenues.

We have consistently opposed elimination of the earnings test. We believe it would represent a fundamental and, we believe, undesirable shift in the philosophy of the program toward an annuity and away from earnings replacement insurance.

Eliminating the earnings test would help only a relatively small number of people—only 1.1 million—who tend to be the most economically advantaged of the aged.

Estimates based on 1976 data, when the exempt amount was $2,760, indicate that where a worker aged 65 to 69 was affected by the earnings test, total income for couples was almost twice—and for single persons three times—the income of those not so affected.

Finally, eliminating the test would have a significant cost for the social security program. If the test were eliminated in 1982, the increased benefit payout for all beneficiaries, including those under age 65, would be $6 to $7 billion. The long-range cost would be 0.25 percent of taxable payroll. If the test were eliminated only for those age 65 and over, the increased benefit payout would be $2.1 billion in the first year with a long-range cost of 0.21 percent of taxable payroll.

As you know, the financial situation in social security is very tight right now. The earnings test could not be eliminated without raising taxes. In effect, this means requiring all of today's younger workers to pay higher taxes in order to finance increased benefit payments to a small number of the highest earners among today's older people.

It is interesting to note that the recent Advisory Council was opposed to liberalizing the earnings test for those over age 65. Even those who favored such a step eventually argued that other program improvements should take priority.

We would not deny that the present structure introduces some degree of work disincentive for a small number of beneficiaries. However, we do not believe that the work disincentive is great enough to justify changing the earnings test at this time.

As I said earlier, the goal of promoting work incentives is only one of a number of sometimes conflicting goals of public policy. It must be balanced against considerations of basic program purpose and the desire to offer benefits that are as adequate as possible to those who need them most. The present structure is, we believe, a reasonable compromise among these conflicting goals.

It is sometimes argued that the elimination of the earnings test would produce a sufficient increase in work activity that the additional income and social security taxes paid would offset most of the cost of the additional social security benefit payments. At the request of the recent Advisory Council, we have studied this question.

Our analysis suggests that among those people aged 65 to 69 who are already working some, but not full time, the elimination of the earnings test would encourage sufficient additional work that, assuming all persons who desired to work more could actually do so, additional income and payroll tax revenues would amount to about 16 percent of the cost of the additional social security benefits.

There is then the question of the number of people age 65 to 69 who, if the test were eliminated, would choose to work for an additional year before retiring. There is no way that we can estimate the response of this kind of people, so instead we supplied several estimates that cover a reasonable range of the possible size of the response.

Basically, if there is no one in this category who continues to work, the total additional payroll and income tax revenues from eliminating the earnings test would still amount to the same 16 percent of the additional benefit payments noted earlier.

On the other extreme, if 10 percent of the people aged 65 to 69 continued to work for 1 more year, we estimate that the additional payroll and income tax revenues would amount to almost 80 percent of the additional benefit payments.

It is clear that eliminating the test would increase the cost of the social security program. Under any of the assumptions in the study, there would be additional payroll and Federal income tax revenues, but not enough to offset the additional social security benefits that would be paid.

Moreover, we should remember that less than half of the added social security and income tax revenues would accrue directly to the social security trust funds.

The greatest gain is to the general fund of the Treasury. In addition, any increase in social security receipts would be distributed among the OASI, DI, and HI trust funds, while the increase in benefits from eliminating the earnings test would be paid out entirely from the OASI fund.

I might note that is the one which is in the tightest financial shape right now.

I want to close by speaking briefly to the differing exempt amounts between those workers under age 65 and those age 65 and over.

As I noted earlier in my prepared statement, there are now two different exempt amounts, one for people under age 65 and one for those 65 and over. This is a result of action taken in 1977. Before the 1977 amendments, the exempt amount was the same for all workers.

The legislative history of the 1977 amendments indicates that the Congress increased the exempt amount only for workers 65 and over to allow them to earn more before any of their benefits were withheld.

They intentionally sought to avoid the increase in cost that would have resulted if the higher exempt amount applied to all workers.

While there is no compelling reason for different exempt amounts, there is also no compelling reason for liberalizing the test for those age 62 to 64. This is because the social security program now includes a provision designed to increase the amount of the social security benefit paid after age 65 to people affected by the earnings test while they are aged 62 to 64.

Most people understand that if they elect to take social security retirement benefits before age 65, their benefits will be permanently reduced. The reduction is designed to provide the early retiree with the same total lifetime benefits as would be received if benefits had started at age 65.

However, many people do not realize that when benefits are withheld from someone under age 65 because of the earnings test, the amount of the permanent reduction is recalculated when the person turns 65.

Specifically, the reduction is recomputed to exclude any month for which benefits were partially or totally withheld under the earnings test. Thus, the monthly benefit paid after age 65 is reduced only to the extent the person actually received a full monthly benefit prior to age 65.

The effect of this procedure is that whenever a monthly check, otherwise payable to someone aged 62 to 64, is partially or totally withheld under the earnings test, the amount lost is repaid over the course of the beneficiary's remaining lifetime beginning at age 65.

Thus, the present provision has the effect of reducing social security benefits during years before age 65 when a beneficiary can and does work and, at the same time, increasing the size of the monthly check paid in later years when the beneficiary may no longer be able to work.

That concludes my statement. I will now be happy to answer any questions the committee may have.

[The prepared statement of Mr. Thompson follows:]

PREPARED STATEMENT OF LAWRENCE H. THOMPSON, ASSOCIATE COMMISSIONER FOR POLICY, SOCIAL SECURITY ADMINISTRATION, ACCOMPANIED BY ROBERT SCHOEPLEIN

Mr. Chairman and Members of the Subcommittee: It is a pleasure to be invited to testify before this Subcommittee and to have the opportunity to discuss one of the most controversial features of the social security program—the social security earnings test.

HISTORY

The social security program has always had an earnings test, although the way in which it has been applied has varied over the years. Under the original Social Security Act of 1935, no benefits were to be paid for any month in which a beneficiary had any earnings whatsoever in employment covered by social security. However, before the first monthly benefits were paid in 1940, the test was changed to provide that benefits would only be withheld for months in which covered earnings were $15 or more.

The earnings test has been modified several times since the 1940's to: allow greater supplementation of social security benefits with earnings; provide that benefits would be reduced more gradually as earnings levels increased; convert the test from a monthly test to an annual one; and broaden the scope of earnings countable under the test.

The Social Security Amendments of 1950 extended social security coverage to many self-employed workers. Since it was impractical to apply a test based on monthly earnings to this group, an annual earnings test was used for them. Under this annual test, one month's benefits was withheld for each $50 (or part thereof) of earnings above a $600 annual exempt amount. However, under an alternative monthly test, full benefits were paid regardless of annual earnings for any month in which the individual did not render substantial services in self-employment. The 1950 amendments also exempted people age 75 and over from the earnings test.

The Social Security Amendments of 1954 extended the annual earnings test to include employees as well as the self-employed, but maintained for both groups the proviso that full benefits could be paid in any month in which wages were below $80 or no substantial self-employment services were rendered. In addition, the test was broadened to include earnings from noncovered work as well as those from covered work and the age at which the test no longer applied was lowered from 75 to 72.

The Social Security Amendments of 1960 introduced the concept of reducing benefits by $1 for each $2 of earnings above the exempt amount. At that time, this treatment was applied only to earnings between the exempt amount, $1200, and $1500 per year. One dollar in benefits was withheld for each dollar of earnings above $1500.

The 1972 amendments eliminated the dollar-for-dollar reduction provision, extending the $1 for each $2 reduction to all earnings levels. They also introduced automatic adjustment of the earnings test exempt amount to increases in average wage levels.

The Social Security Amendments of 1977 further increased the exempt amount for beneficiaries age 65 and over, and, effective in 1982, lowered the age at which the test no longer applies from 72 to 70. The 1977 amendments also eliminated the monthly earnings test, except for the year of retirement. The elimination of the monthly test was designed to treat people with irregular earnings in the same way as people with the same total annual earnings earned regularly over the course of a year.

PHILOSOPHY

Social security has always been viewed as an earnings replacement program. Workers and their dependents are insured against the risk of earnings loss as a result of retirement, disability or death and benefits are designed to partially replace the earnings that are actually lost.

Private pension plans almost always require the person to stop working in employment covered by the plan as a condition for eligibility for their benefit payments; multi-firm plans generally require that workers leave the entire industry. If social security were structured like most private pension plans, people would be required to cease all work in employment covered by social security in order to qualify for social security benefits. As I noted earlier, this was the arrangement contemplated for social security in 1935, but never actually put into effect.

There is in the way the earnings test is presently structured, however, a recognition of other important programs or social goals. As a result, the test is now structured so that the principle that benefits should be paid only to those whose covered work income has ceased, is balanced against principles that reflect at least three other goals.

The first goal is to allow people to supplement their social security benefits through a limited amount of earnings. This may be especially important for many lower-income workers who do not have income from pensions or savings in addition to their social security benefits. It is sometimes said that "work is the poor man's pension."

The second goal is to preserve incentive and opportunity to work among the aged, and to assure the aged who do work that they will be better off financially as a result of their work effort.

The third goal is to provide that those who work well past the normal retirement age will get something back for the social security taxes they have paid.

Let me next explain how the present test works and then discuss how it is structured to promote each goal.

HOW THE PRESENT TEST WORKS

1. There is an annual exempt amount.—A person whose annual earnings do not exceed this exempt amount is considered to be fully retired and receives full social security benefits for the year.

A person's exempt amount depends upon the person's age. For people age 65 and over the annual exempt amount is $5,000 in 1980, $5,500 in 1981, and $6,000 in 1982. After 1982, this amount will be automatically adjusted annually to reflect increases in average wages.

For people under age 65, the annual exempt amount is $3,720 in 1980 and is automatically adjusted annually to reflect increases in average wages. In the 1980 Trustees' Report it is estimated that the exempt amount for those under age 65 will be $4,440 in 1982, as compared to $6,000 for those age 65 and over.

2. There is a $1 for $2 withholding rate.—One dollar in benefit is withheld for each $2 of earnings above the annual exempt amount.

3. There is a monthly test in the year of retirement.—A special provision in the law allows people who retire in the middle of the year to receive full benefits for the remainder of that year regardless of how high their earnings were before retirement. This year in which a monthly earnings test is still used is generally called the "grace year."

4. An exemption on account of age.—The earnings test does not apply beginning with the month a person reaches age 72. Beginning in 1982, the test will cease to apply when the person turns 70.

EFFECT OF PRESENT TEST

Let me now discuss how the earnings test represents a balancing of competing objectives.

First, the very existence of the earnings test reflects a desire to restrict payments to those who have retired. This is similar to the objective served in private pension plans when they require the individual to cease working in employment covered by the pension system.

Second, the fact that we establish an amount that a person can earn each year without any loss of social security benefits allows all beneficiaries some room to supplement their benefits with earnings without any penalty.

Third, both the exempt amount and the $1 for $2 withholding rate for earnings over the exempt amount guarantees that people are better off financially if they work. This preserves the fairness of the system and enhances work incentives.

Finally, having an upper age limit at which the earnings test no longer applies (72 at present, 70 by 1982) allows people who may never retire (e.g., some farmers and other self-employed people) to obtain a decent return for participating in the program.

No compromise is ever perfect, but we believe that the effect of the present provisions is a reasonable balancing of diverse and, in some cases, conflicting goals. I should also note, that the net effect of these provisions is that the present test affects far fewer people and effects them far less dramatically than is sometimes realized. For example, in 1980 for a person who always had earnings equal to the national average, benefits are totally withheld only if earnings are above $16,725; for a person who always had earnings at the maximum level covered by social security, benefits are totally withheld only if earnings are above $19,874.

ELIMINATING THE EARNINGS TEST

Some people argue that the earnings test should be eliminated totally, at least at age 65. They argue that workers have "paid for" their social security benefits through the payroll tax payments they and their employers have made over the years and that they should receive benefits at age 65 regardless of continued work or earnings. They also argue that eliminating the test would further encourage work among the aged and produce additional payroll tax and Federal income tax revenues.

We have consistently opposed elimination of the earnings test. We believe it would represent a fundamental and, we believe, undesirable shift in the philosophy of the program toward an annuity and away from earnings replacement insurance. Eliminating the earnings test would help only a relatively small number of people (only 1.1 million) who tend to be the most economically advantaged of the aged. Estimates based on 1976 data, when the exempt amount was $2,760, indicate that where a worker aged 65–69 was affected by the earnings test, total income for couples was almost twice—and for single persons, three-times—the income of those not so affected.

Finally, eliminating the test would have a significant cost for the social security program. If the test were eliminated in 1982, the increased benefit payout for all beneficiaries including those under age 65 would be $6 to $7 billion; the long-range cost would be .25 percent of taxable payroll. If the test were eliminated only for those age 65 and over, the increased benefit payout would be $2.1 billion in the first year with a long-range cost of .21 percent of taxable payroll.

As you know, the financial situation in social security is very tight right now. The earnings test could not be eliminated without raising taxes. In effect, this means requiring all of today's younger workers to pay higher taxes in order to finance increased benefit payments to a small number of the highest earners among today's older people. It is interesting to note that the recent Advisory Council was opposed to liberalizing the earnings test for those over age 65. Even those who favored such a step eventually argued that other program improvements should take priority.

We would not deny that the present structure introduces some degree of work disincentive for a small number of beneficiaries. However, we do not believe that the work disincentive is great enough to justify changing the earnings test at this time. As I said earlier, the goal of promoting work incentives in only one of a number of sometimes conflicting goals of public policy. It must be balanced against considerations of basic program purpose and the desire to offer benefits that are as adequate as possible to those who need them most. The present structure is, we believe, a reasonable compromise among these conflicting goals.

It is sometimes argued that the elimination of the earnings test would produce a sufficient increase in work activity that the additional income and social security taxes paid would offset most of the cost of the additional social security benefit payments. At the request of the recent Advisory Council, we have studied this question.

Our analysis suggests that among those people aged 65 to 69 who are already working some, but not full time, the elimination of the earnings test would encourage sufficient additional work that, assuming all persons who desired to work more could actually do so, additional income and payroll tax revenues would amount to about 16 percent of the cost of the additional social security benefits.

There is then the question of the number of people aged 65 to 69 who if the test were eliminated, would choose to work for an additional year before retiring. There is no way that we can estimate the response of these kind of people, so instead we supplied several estimates that cover a reasonable range of the possible size of the response. Basically, if there is no one in this category who continues to work, the total additional payroll and income tax revenues from eliminating the earnings test would still amount to the same 16 percent of the additional benefit payments noted earlier. On the other extreme, if ten percent of the people aged 65 to 69 continued to work for one more year, we estimate that the additional payroll and income tax revenues would amount to almost 80 percent of the additional benefit payments.

It is clear that eliminating the test would increase the cost of the social security program. Under any of the assumptions in the study, there would be additional payroll and Federal income tax revenues, but not enough to offset the additional social security benefits that would be paid. Moreover, we should remember that less than half of the added social security and income tax revenues would accrue directly to the social security trust funds. The greatest gain is to the general fund of the Treasury. In addition, any increase in social security receipts would be distributed among the OASI, DI, and HI trust funds while the increase in benefits from eliminating the earnings test would be paid out entirely from the OASI fund.

LIBERALIZING THE EXEMPT AMOUNT FOR BENEFICIARIES UNDER AGE 65

As I noted earlier, there are now two different exempt amounts, one for people under age 65 and one for those 65 and over. This is a result of action taken in 1977. Before the 1977 amendments, the exempt amount was the same for all workers.

The legislative history of the 1977 amendments indicates that the Congress increased the exempt amount only for workers 65 and over to allow them to earn more before any of their benefits were withheld. They intentionally sought to avoid the increase in cost that would have resulted if the higher exempt amount applied to all workers.

While there is no compelling reason for different exempt amounts, there is also no compelling reason for liberalizing the test for those age 62–64. This is because the social security program now includes a provision designed to increase the amount of the social security benefit paid after age 65 to people affected by the earnings test while they are aged 62–64.

Most people understand that if they elect to take social security retirement benefits before age 65, their benefits will be permanently reduced. The reduction is designed to provide the early retiree with the same total lifetime benefits as would be received if benefits had started at age 65. However, many people do not realize that when benefits are withheld from someone under age 65 because of the earnings test, the amount of the permanent reduction is recalculated when the person turns 65. Specifically, the reduction is recomputed to exclude any month for which benefits were partially or totally withheld under the earnings test. Thus, the monthly benefit paid after age 65 is reduced only to the extent the person actually received a full monthly benefit prior to age 65.

The effect of this procedure is that whenever a monthly check, otherwise payable to someone aged 62 to 64, is partially or totally withheld under the earnings test, the amount "lost" is repaid over the course of the beneficiary's remaining lifetime beginning at age 65. Thus, the present provision has the effect of reducing social security benefits during years before age 65 when a beneficiary can and does work and, at the same time, increasing the size of the monthly check paid in later years when the beneficiary may no longer be able to work.

This concludes my statement. Once again, thank you for inviting me here today and I'll now be happy to answer any questions that you may have.

Mr. **Burton.** You said the elimination of the earnings test would perpetrate an unfairness? Do you recall anything like that in your statement?

Mr. **Thompson.** I am not sure we use the word "unfair."

Mr. **Burton.** Perpetuate an inequity, an unfairness. Wait a minute. Maybe that was on page 7. You said it preserves the fairness of the system.

Mr. **Thompson.** Yes.

Mr. **Burton.** How? In other words, how does the maintenance of the earnings test preserve the fairness of the system?

Mr. **Thompson.** That is embedded in the section where I was trying to discuss how the present structure is designed to serve to balance several competing objectives.

One objective, which many people disagree with, that has historically been in the social security program, is that we are replacing lost earnings and, therefore, there should be some lost earnings before the replacement is triggered.

I got to a third objective, which was to provide that if someone worked, their total income went up as a result of the work. I was saying that the $1 for $2 withholding rate serves that purpose. There was a time when for every dollar you earned—if your earnings were in a certain range—your social security benefit went down by $1; so the additional work had no effect on your total income, including social security.

The introduction of the $1 reduction in social security benefits for each $2 earned introduced what I believe is an element of fairness as you work in that your income does go up, although it is true that it does not go up by the total amount of your additional earnings, if you are in the range where the Social Security benefit is being reduced.

Mr. **Burton.** What is the difference if you are 66 or 71? We have gone away from the initial concept—a concept that is older than any members of this committee, I would suspect.

So, what is the difference?

Mr. **Thompson.** Mr. Chairman, it is arbitrary.

Mr. **Burton.** It is arbitrary. So 65 would be just as arbitrary.

Mr. **Thompson.** Yes, sir. There is another concern that Congress had dating from the time when the self-employed were first covered by social security, and that is that many self-employed people never really quite retire.

A farmer continues to farm. He may not farm as much, but he continues to farm. Bringing him under social security, if he is never going to retire, would cause him to pay the tax and never receive a benefit. Other farmers do retire and will get their benefits.

So a compromise was made. The compromise was that the earnings test would cease to apply at a certain age. It was first age 75. For a long time it was age 72. The 1977 amendments provided that, beginning in 1982, it would be age 70. There is nothing magic about 70.

Mr. BURTON. Right. So it would be just as arbitrary and just as defensible to be age 65, except for the problem of expenditures out of the fund, right?

Mr. THOMPSON. I think you have to decide if you believe that social security should basically be an annuity that, when you have turned 65 and worked for the requisite number of quarters, triggers the benefit no matter what, or whether you believe that social security should basically be earnings replacement, and the benefit is triggered when the earnings are lost.

Mr. BURTON. How about income replacement? You can turn 65 and be a multimillionaire. Some friends of mine get social security without losing a dime.

Mr. THOMPSON. That is correct.

Mr. BURTON. And their biggest thrill is to show you the check, because they don't need it. They were all self-made people so they qualified for social security while they were working for wages. Then they made some prudent, if not lucky, investments and became the wealthiest men in San Francisco. At least once a year one man is on the front page of the newspaper showing a social security check, full payment, no deduction. He turned 65 and got it.

My mother turned 65. She worked. She gets a deduction. You are saying it is arbitrary.

Mr. THOMPSON. The philosophy is that we are replacing earnings. The program is financed by a tax on earnings. At the moment—

Mr. BURTON. Tax is another one of the inequities. Social security doesn't tax people—if you made $200,000 a year on unearned income, you pay nothing into the fund.

Mr. THOMPSON. That is correct. And you are not covered by the social security program. The program is geared towards earnings. You are taxed if you earn, and you receive benefits when you stop earning.

Unearned income has no effect either when it comes time to compute your tax liability or when it comes time to compute whether you are eligible for benefits. It has traditionally been viewed as one of the strengths of the program that the man you referred to in San Francisco will get his social security check, that the benefits are paid without regard to need.

The fact that a man who is wealthy gets a social security check, also means that when a poor lady who is living down the street, and no one knows what her income is, when she cashes the social security check, they don't know her income is low.

Mr. BURTON. I think they can tell the difference between the guy in the homburg and the spats and some lady coming in with her shopping bag, with cat food instead of tunafish, because that is all she can afford. I think they know the difference.

I don't know. At least a lot of the clerks in San Francisco are very perceptive that way.

The House, as I recall—and I think it was an amendment by our colleague, the late Bill Ketchum—in 1977 removed the earnings limit.

Mr. THOMPSON. That is correct, for people over age 65.

Mr. **Burton**. We removed it, I think, substantially. It was in conference with the Senate that they came up with this compromise. So the House in effect did speak on this issue.

In my judgment, the only argument you can make about the wisdom of not moving it from 70 to 65 is the fiscal shape of the trust fund as against policy. Because 75, 72, 70, 65 are all arbitrary. You can just pick a number and put it in. But it is really the fiscal implications that I would assume concern you more than the policy ones.

Mr. **Thompson**. Sir, we have a difference of opinion there.

Mr. **Burton**. Why was the age dropped from 75 to 72? That was a policy change. As you say, it is arbitrary.

Mr. **Thompson**. I can speak to the 72 to 70. That was a compromise on the floor of the Senate. The earnings test——

Mr. **Burton**. It was an arbitrary compromise.

Mr. **Thompson**. Of course. The earnings test itself, as I tried to say—I perceive the earnings test as a compromise between conflicting goals. On the margin you adjust the way that compromise goes. You increase the exempt amount by a little bit or lower the age at which the test no longer applies.

Quite frankly, whether you lowered it from 72 to 71 or 70 is arbitrary.

Mr. **Burton**. It should go no further.

Mr. **Thompson**. That is our belief.

Mr. **Dornan**. Mr. Chairman, could I ask a brief question.

Mr. **Burton**. Could you wait. There are a lot of people here before you.

Mr. **Dornan**. Just on numbers. Where did you get the 1.1 million figure?

Ms. **Oakar**. We are going to get to that.

Mr. **Dornan**. OK.

Mr. **Burton**. The second bell has rung. We will be in recess to vote. We will be right back.

[A brief recess was taken.]

Mr. **Burton**. I have one further question.

I was at a town meeting in my district. There was an individual who is collecting social security but also working. He has a payroll job, and is paying into the social security fund. But he was complaining that his social security payments did not reflect his increased and continued contribution to the fund.

Do you understand the problem?

Mr. **Thompson**. Yes, I think I do. It depends on the individual. When someone continues to work, at the end of the calendar year——

Mr. **Burton**. What if he stopped and went back?

Mr. **Thompson**. It doesn't make any difference. At the end of any calendar year, if they had more earnings, we will go back and recompute their benefit.

If by entering that year of earnings—let's say they worked in 1979—effective in January of 1980, although it takes some time to do it, so they won't get it by the January check, they are entitled to a higher benefit if entering the 1979 earnings produces a higher benefit.

It all depends on whether that year replaces another year in heir average. Of course, the benefit is based on the average of a ertain number of years. Some years are already dropped out. It ust depends upon the relationship between the average earnings hat we are already using to compute benefits and the size of the earnings in the additional year.

Mr. BURTON. So it is conceivable, depending on past work patterns, that an individual would not receive any increased benefit?

Mr. THOMPSON. Yes, it is possible. I think it is more common that they do, but it is certainly possible they would not.

Mr. BURTON. Wouldn't that make a case that people are contributing payroll taxes into the fund and not receiving a benefit from it. Could that be considered one of the arguments for raising or eliminating the earnings test? Maybe not from your standpoint. Maybe not from your standpoint, but just as a general equity issue.

Mr. THOMPSON. I think so. It is a little bit of a slippery argument because there are a lot of people who at one time or another will pay into the fund and may never get a benefit back.

You do have to work for 7½ years or so at the present time under social security in order to be eligible for retirement benefits. There are people who worked less than that, paid their taxes, but don't receive any benefits.

We struggle with the problem of people who, let's say they are French nationals and over here working for 2 years for a French corporation, but they are working in American employment covered by social security. They will pay their tax right now.

So that when you start saying that everyone who pays a tax ought to get a benefit or a higher benefit, then there are lots of other situations. You have to think those things through and find out whether that is a principle you like.

I may also add, if I may, there was a time when you did not pay a tax after you reached age 65. The social security tax no longer applied. That didn't last very long. I have forgotten the year it was changed. It may have been as early as 1940.

My understanding is one of the reasons it was changed, is that you not only didn't pay a tax, but you didn't get any credit for those earnings. You would run into a situation where people were two quarters short of being eligible for a benefit when they reached age 65 and there was no way they could ever get the two quarters.

So, in doing some people a favor, it turned out we have been doing a great disservice to another set of people. That is one of the reasons the law was changed.

Mr. BURTON. Ms. Oakar?

Ms. OAKAR. Thank you, Mr. Chairman.

Mr. Thompson, quite honestly, your testimony gives the impression that the philosophy of the system is kind of sealed in cement, and the fact is that it has really been an evolving system.

I mean, what is true for the thirties is no longer true of the eighties, in terms of where women are, in terms of the fact that people live a lot longer today than they did in 1935, et cetera. So it has really been an evolving system.

I have a real difficulty with you saying that, "We have consistently opposed elimination—we believe"—it is as if the system philosophically has not evolved.

I know Wilbur Cohen very well, who served on the original task force, and he says it is just great the way the system has changed with the times. He is suggesting some other changes. So I really challenge that.

For example, in 1960 the earnings test indicated you could earn no more than $1,200 below $1,500 and so on. Then we changed it to $5,000. So it has been an evolving system.

Also on page 3 you say—and I think it is a little bit misleading because you are not telling the whole story here—at the bottom paragraph you say, "Private pension plans almost always require the person to stop working in employment covered by the plan as a condition," which indicates they do it, and so you are comparing it with social security.

What you are not mentioning is if I am a Federal employee and I retire from being a Federal employee, nothing stops me from getting some other kind of job, right?

Mr. **Thompson**. Right.

Ms. **Oakar**. OK. And the social security system is covered under all kinds of types of employment, am I correct?

Mr. **Thompson**. Yes.

Ms. **Oakar**. So how can you make that kind of comparison in terms of saying that we ought to treat it like a private pension plan, because it is not the same type of treatment. I am saying we should treat it the way we do private pension plans in the sense that nothing stops me in practically any other pension plan from going out and getting another job and still collecting my pension.

Mr. **Thompson**. May I respond.

First, on the question of the philosophy, I would agree with you wholeheartedly that one of the strengths of social security is that it adjusts and changes as society changes. I would certainly not want to suggest that one should not consider making a change in the law which attempted to change one of the philosophical bases that we inherited. We should feel free to make any changes that we believe are wise.

I want to point out that in doing away with the earnings test you are making that kind of a change. I want you to understand that, if that is the will of the Congress.

Ms. **Oakar**. We have been leading toward that for a number of years. As the chairman pointed out, the House did vote to change it. The Senate did not concur.

Mr. **Thompson**. Let me address the private pension comparison if I could, please, the comment you just made. I think maybe I should have elaborated slightly and said that—I am trying to point out how private pensions work.

Really, the message I think one should get is that it is probably impractical to use the private pension model for social security. If you use the private pension model, if you just closed your eyes and said let's structure social security like private pensions, with regard to this question of what you can earn or can't earn, you would produce something that would make you even more unhappy. You would say you cannot work anywhere in covered employment.

I cannot as a Federal servant work for the Government and get my pension plus my salary.

Ms. Oakar. Yes, but you have a wonderful option as a Federal employee to get a fairly decent pension, and then leave and get another job. I understand that very well.

Mr. Thompson. That is the case in almost all private pensions.

Ms. Oakar. That is right. A retired teacher can do the same thing.

Mr. Thompson. The only exception I know is the United Auto Workers, where they have an earnings test very much like the social security one.

Ms. Oakar. I do want to ask you another question. I don't want to monopolize the time.

I want to get to page 8 because I really seriously question a statistic that you gave. I have to be honest. Some of the legislation I have introduced, I find when we ask certain individuals at the Social Security Administration for estimates, they are unbelievably astronomical in terms of what certain legislation would cost and so on.

Then you find somebody else in another department who says really it is not that high, either. So there seems to be a kind of negative feeling within the Social Security Administration for change because it is just too much of a hassle to change. That is why I really question some of these statistics.

It would be interesting to know what they are based on. One that really got me was when you said on page 8, the first paragraph, "Eliminating the earning test would help only a relatively small number of people, only 1.1 million, who tend"—that is unbelievable—"who tend to be the most economically advantaged of the aged."

I have to tell you, I would challenge that. I would like to know where you got your information. Let me ask you something in terms of that.

What is the median income for an elderly person in this country, who is 65 years or over?

Mr. Thompson. I don't have that number with me.

Ms. Oakar. You don't know that. Would you think it is over $10,000 or under $5,000?

Mr. Thompson. For all people, or all people affected by the earnings test?

Ms. Oakar. For all older people who are 65 or older. What is the median income? What is the median income for people over 65 in this country?

Mr. Thompson. I don't have it with me.

Ms. Oakar. I think it is a significant question.

Mr. Thompson. It is. I will supply it for the record.

[The following information was subsequently received:]

The median money income level for nonmarried persons aged 65 and older for 1978 is $3,910. For married couples aged 65 and older the median money income level for 1978 is $9,460. The median money income level for all aged units (couples and individuals) aged 65 and older for 1978 is $5,630.

This is the latest information available, and these amounts were computed based upon data from the March 1979 Current Population Survey (CPS), which was conducted by the Bureau of the Census.

Ms. Oakar. Some people agree, disagree, whatever. But our statistics say it is about $4,000 a year. All right, if that is true, wouldn't you agree that most of those people are living on some kind of pension that indeed they are retired, and most of those people are living solely on social security.

So, I am not going to give intimate research, but let me tell you, if that is true, that the average person lives on about $4,000 a year, it is true that most of them live on social security, then your statement that only 1.1 million people would benefit from eliminating it, unless you feel that $4,000 is a lot of money to live on, really.

Mr. **Thompson**. People living on $4,000 are not affected by the earnings test. You get to earn $5,000 before you lose a nickel of benefits.

Ms. **Oakar**. Yes, but they can only make $1,000 more.

Mr. **Thompson**. No. They are living on $4,000, you said, without working. They can earn $5,000, for a total of $9,000, before it will take away the first nickel.

Ms. **Oakar**. Do you think that is a lot of money to live on?

Mr. **Thompson**. I think what the statement says is that of the aged, the ones who are having their benefits withheld on account of the earnings test are those who in general have the highest incomes because the ones who have the low incomes are not working.

Ms. **Oakar**. Maybe because there is a disincentive, it is not worth the hassle?

Mr. **Thompson**. I think there would be some people like that, but as I said, the test is structured so your income does go up as a result of work.

Ms. **Oakar**. Let me just say this. I just really question some of your statistics here. I think for the record it would be interesting to know what primary sources you used. I mean, did you interview 500 people or did you just take the total number and punch them in?

Mr. **Thompson**. I would be happy to supply that.

Ms. **Oakar**. I think that is very important.

Mr. **Thompson**. I believe we ran the master beneficiary record. It shows how many people are receiving social security benefits, and we compare the estimates that the actuaries produce of how many are eligible.

[The following information was subsequently received:]

NUMBER OF SOCIAL SECURITY BENEFICIARIES AGED 65 AND OVER WHO HAVE SOME OR ALL OF THEIR BENEFITS WITHHELD DUE TO EXCESS EARNINGS UNDER THE EARNINGS TEST

The estimate that 1.1 million persons aged 65 and over would be affected by the elimination of the earnings test is based primarily on SSA's Continuous Work History Sample. This is a 1-percent sample of all persons with a social security account number. From this sample all insured workers aged 65 and over with taxable earnings during the year are considered. Based on the earnings, calculations are then made of the annual number of beneficiaries who would have some or all benefits withheld under the earnings test. From those calculations, projections are made of the number of beneficiaries who will have some or all of their benefits withheld because of the earnings test in some future year.

Ms. **Oakar**. Then on page 11 you say it would increase the cost of the program, et cetera. I don't see a whole lot of basis for that, but I really feel that it would be helpful to know that.

You also mention the Advisory Council, some of whose points are very well chosen. But of course the one that made the headlines, for better or worse, was the fact that they wanted to tax it.

Thank you, Mr. Chairman, very much. I think for the record we ought to know how these conclusions are made because it has been my experience with the administration that you can find individuals within the system who supply different statistics based on different avenues.

Thank you.

Mr. **Thompson**. We will be happy to supply that.

[The following information was subsequently received:]

The Cost of Eliminating the Earnings Test

The cost estimate of $6 to $7 billion for eliminating the earnings test is based on two sources of data. The cost attributable to the earnings of retired workers is based on SSA's continuous work history sample which is a 1-percent sample of all persons with a social security account number. From this sample all insured workers aged 62 and over with taxable earnings during the year are considered. Calculations are then made of the annual amount of benefits withheld under the earnings test.

The cost due to the earnings of survivors or dependents of retired or disabled workers is based on special data developed quarterly from SSA's master beneficiary record which contains the records of all OASDI beneficiaries. This special data includes the amounts of benefits withheld under the retirement test due to the survivor's or dependent's earnings on a 100-percent basis.

In both cases, projections are then made of the increased benefit payments if the earnings test were to be eliminated in some future year.

Mr. **Burton**. Ms. Ferraro?

Ms. **Ferraro**. Thank you, Mr. Chairman.

I want to tell you I think your testimony has been excellent. I appreciate it. I don't agree with you philosophically. I am most concerned about the fiscal constraints that are placed currently on the system and upon the taxpayer.

You heard Ms. Sommers testify. She said that on page 4 of her testimony, if in fact social security remains locked into payroll taxes any liberalization and certainly elimination of the retirement test would probably come out of the hides of older women, especially dependents' benefits.

Do you agree with that?

Mr. **Thompson**. I am not sure that I do, but I respect her right to have that opinion.

Ms. **Ferraro**. She was concerned about it coming out of that particular trust fund.

Mr. **Thompson**. She is essentially concerned that if benefits were increased in one place that they would be offset by a decrease someplace else. I guess I am in no better position than you—or maybe in a worse position—to predict exactly how the Congress would adjust.

Secretary Harris, just a few days ago in commenting on the current financial status of the social security program, made it very clear that she, herself, did not support any benefit reductions as a way of addressing the financial situation.

Ms. **Ferraro**. Where did she see the help coming from—from general revenues?

Mr. **Thompson**. Our recommendation for the first step is that the Congress give the trustees the authority they have sought to make loans from one fund to the other—perhaps in combination with their reallocation between OASI and DI, the two cash benefit programs; and that, for the moment, is what should be done.

Ms. **Ferraro**. So the other funds, the disability and health insurance, they are in good shape?

Mr. **Thompson**. They are in better shape than we thought they were going to be in 1977. It turns out a good deal of the problem is a misallocation of the revenues among the three funds rather than a shortage of revenues for all three funds combined.

But depending upon the future course of the economy over the next 4 or 5 years, there could indeed be a shortage for all three funds combined.

But the uncertainties for the economy are such that the administration believes that the first thing is to get the flexibility—in essence move some money, repay it, but move some money from the other two funds into OASI—until it becomes a little clearer what the dimensions of the problem are.

Ms. **Ferraro**. That is just to meet the current problem. That is not to meet any additional problem which might be caused if we eliminated the earnings test.

Mr. **Thompson**. That is correct. Under the intermediate assumption of the trustees report, the report released last week, the three funds combined do have sufficient revenues; but as the trustees themselves say, the difference between what they have got and what they will need is very, very small.

Ms. **Ferraro**. Thank you. I have no further questions.

Mr. **Burton**. What is the cost of administering the earnings test?

Mr. **Thompson**. I am told in fiscal year 1981 it is estimated that the total cost for administering the earnings test will be $71 million. That is in wages and salaries.

Mr. **Burton**. So that is an offset?

Mr. **Thompson**. Yes, sir.

Mr. **Burton**. All right. Of the $6 to $7 billon cost that they talk about for eliminating the earnings test for all beneficiaries, how much is attibutable if we eliminated it for retirees 62, 63, 64?

Mr. **Thompson**. Mr. Chairman, I want to correct the number I just gave you and then I will have to ask you to ask the question again.

I think a better estimate of the fiscal year 1982 cost of administering the earnings test for all beneficaries is $128 million.

[The following information was subsequently received:]

Note.—This cost estimate was later revised to $112 million.

Mr. **Burton**. So using Senator Goldwater's figures, that is $128 million off of $400 million. According to Senator Goldwater's testimony, was that offset of administrative costs included in his?

Mr. **Thompson**. No.

Mr. **Burton**. So he would be using his figure down to $400 million minus $128 million in 1982?

Mr. **Thompson**. That is for eliminating the earnings test entirely. Senator Goldwater was advocating eliminating it only for people age 65 and older. That administrative cost is $68 million.

Mr. **Burton**. OK.

What is the cost of eliminating the earnings test for those 62, 63, 64? Do you have it broken down, for those figures?

Mr. **Thompson**. Not by single year.

Mr. **Burton**. What about the combined lump sum of those 3 years.

Mr. **Thompson**. Roughly $4 billion.

Mr. **Burton**. It's $3 to $4 billion for those ages?

Mr. **Thompson**. Our estimate is roughly $4 billion.

Mr. **Burton**. How much is it if you eliminated it for dependent beneficiaries, such as students?

Mr. **Thompson**. That is about $1 billion.

Mr. **Burton**. $1 billion.

Mr. **Thompson**. $1 billion for all people under age 62.

[The following information was subsequently received]:

Note.—This cost estimate should have been $0.3 billion.

Mr. **Burton**. OK, that is fine.

Where does the $2.1 billion figure come from?

Mr. **Thompson**. That is over age 65, 65 and over.

Mr. **Burton**. 65 and over.

Mr. **Thompson**. That is in 1982, after the age has been lowered.

Mr. **Burton**. OK.

Mr. **Thompson**. It is $2.1 billion for age 65 and over, roughly $4 billion between ages 62 and 64, and about $0.3 billion for people under age 62.

Mr. **Burton**. The way the earnings test is structured, the retirees with lower benefits lose all of their benefits at a lower total earnings level. Is that a fact?

Mr. **Thompson**. That is correct.

Mr. **Burton**. All right. Instead of doing benefits by age, could you think of a low retirement benefit that we might put in, to eliminate earnings for people who only receive so in benefits? Does that get complicated?

Mr. **Thompson**. I think it does get complicated. It is also not always clear—people who have low social security benefits get them for a number of different reasons. I think you are trying to help the person who got those low benefits because their earnings were low while they worked.

Mr. **Burton**. Yes.

Mr. **Thompson**. But there are also people who didn't work very long in covered employment, may have worked a long time in noncovered employment, who you may not feel the same way toward.

That is why it gets difficult when you target something on just the benefit level.

Mr. **Burton**. So the easiest way, not that you agree with it, to do it would be some type of an across-the-board policy change at a specific age.

Mr. **Thompson**. I think administratively—and from the standpoint of knowing what you are doing and who you are going to help—that would probably be the easiest way to do it.

Mr. **Burton**. Thank you very much for your testimony. We may have some written questions that we would like to send to you later. Thank you, again.

Next we have a panel for retaining or liberalizing the earnings test. Henry Aaron, senior fellow, Brookings Institution; Rudolph Penner, director of tax policy studies, American Enterprise Institute; and Jack Ossofsky, executive director, National Council on the Aging.

Why don't you start, Mr. Aaron.

PANEL FOR RETAINING OR LIBERALIZING THE EARNINGS TEST, CONSISTING OF HENRY AARON, SENIOR FELLOW, BROOKINGS INSTITUTION, AND CHAIRMAN, ADVISORY COUNSIL ON SOCIAL SECURITY; RUDOLPH G. PENNER, DIRECTOR OF TAX POLICY STUDIES, AMERICAN ENTERPRISE INSTITUTE; AND JACK OSSOFSKY, EXECUTIVE DIRECTOR, NATIONAL COUNCIL ON THE AGING

STATEMENT OF HENRY AARON

Mr. AARON. I would like to thank you, Mr. Chairman, for the opportunity to testify concerning the desirability of relaxing or removing the social security retirement test. I had such a good time last time I was here, and my testimony was so well received, I could not resist the temptation to come back again.

I shall refer to the recomendations of the Advisory Council on Social Security, which reported last December, and which I chaired. I will argue that the earnings test should remain as it is.

For decades the case for the retirement test has been uneasy. It was introduced at least in part because one of the original objectives of the social security system unabashedly was to encourage people to leave the labor force to make room for the unemployed, a justification that I argue in my written statement is no longer valid or correct, if it ever was.

I would hold the position that to the extent that the retirement test discourages work, it distorts economic behavior that could increase gross national product and that could help reduce inflation.

So, the effects of the retirement test on work incentives, are one strike against it.

The other argument for the retirement test—that social security is and should remain a system of earnings replacement, rather than an annuity—requires support. You have heard or will hear arguments about why Social Security should be convered into an annuity. You will hear how the elderly find themselves face to face with a 50-percent tax rate on earnings, imposed in addition to payroll and income taxes, and that such taxes discourage work. Remember that that is what they were originally intended to do.

You will hear that the net earnings from such work would, if the earnings tax did not discourage it, contribute in an important way to the income needs of the elderly. You may hear that the earnings test encourages some elderly not to report earnings that they receive, and that the elderly should receive social security benefits because they have paid for them.

I believe that there is some validity in each of these arguments, except the last, which is without merit because the actuarial value of benefits that 65 year olds now can expect to receive after the retirement test ceases to operate—at age 72 today, age 70 after 1982—far exceed the actuarial value of taxes paid.

So, I see some arguments why the requirement test should be relaxed or removed. But removing the retirement test entirely would increase the cost of social security $6 billion to $7 billion.

Removing it only for those over age 65 would cost $2.6 billion in 1981 and $2.1 billion in 1982. In theory, it would be possible to pay for such an increase in social security by curtailing low priority Federal expenditures and diverting the general revenues saved into the social security system. In practice, the chances of pursuing this course are slim. So, as a practical matter, the cost of removing or liberalizing the retirement test would have to be met by increasing payroll taxes or reducing other social security benefits. Are the benefits worth the cost?

To answer that question, we have to specify the benefits. The most important would be the removal of a work disincentive affecting the aged. Anthony Pellechio estimated that removing the retirement test in 1972 would have increased the number of person years worked by the aged by only about 10 percent. It is apparent that the lion's share of the cost of removing or liberalizing the retirement test would go to pay for extra benefits for aged who are working today and would continue to work after the retirement test was removed.

Who are these people? We know that they are earning at least $5,000 because the retirement test does not apply below that amount. We know that a worker who has average earnings during his career can receive $12,620 in earnings and benefits before any benefit is withheld. We know that such a worker will continue to receive some social security benefits until his earnings exceed $20,240 if he or she is married. In short, we know that the group that would benefit most from liberalizing or removing the retirement test is the fraction of the aged, much below half, that is financially much better off than average.

If you have been forced to retire because of ill health, removing or liberalizing the retirement test will do nothing for you. If you are healthy and want to work part time, liberalizing or removing the retirement test may be of some value. But if you have your health and keep on working, particularly if you are a highly paid professional, like a doctor, a lawyer, an accountant, a real estate broker, or an insurance salesperson, then this proposal is a bonanza.

My point is not that doctors, lawyers, accountants, brokers, and salespeople are undeserving. I would like to see them receive more in social security, particularly if as a byproduct it were possible to remove a disincentive to work.

But in this year, more than in most, Congress should weigh the importance of providing higher benefits to the relatively well-to-do aged, most of whom work now and would continue to do so if the retirement test were ended, against other competing needs under the Social Security Act.

Let me indicate a few. By a simple revision of the social security benefit formula, Congress can assure that no social security beneficiary with long attachment to the labor force need have an income below the poverty threshold.

It can increase the minimum benefit under the supplemental security income program so that no aged or disabled person need live in poverty. It can increase the grants for social services made to the states under title XX of the Social Security Act, many of which are of direct value to the aged, especially for the homebound or frail elderly.

I believe that if Congress wants to help the elderly, these are the elderly who deserve first consideration.

At some future date, it may be desirable to remove the retirement test in order to reap the benefits of improved work incentives for the aged. But that time, in my opinion, should come only after the much more pressing problems of the aged poor, disabled, and sick have been met.

It should certainly not come at a time when public spending is under intense and justified pressure and higher priority uses of public funds than removal of the retirement test are casualties in the war against inflation.

I will submit the remainder of my statement for the record. In that statement, I talk briefly about partial removal or liberalizations of the retirement test, including reference to a novel idea advanced by Prof. Peter Diamond of MIT, which a near majority, 6 out of the 13 members of the Advisory Council, felt was a desirable improvement.

I found myself on the majority in this case at least for the present and think the idea is interesting and deserves study, but has certain aspects that should give us pause.

[The prepared statement of Mr. Aaron follows:]

PREPARED STATEMENT OF HENRY AARON [1] [2]

Mr. Chairman, thank you for the opportunity to testify concerning the desirability of relaxing or removing the social security retirement test. I shall refer to recommendations of the Advisory Council on Social Security which reported last December and which I chaired.

As you know the Social Security System at present has two retirement tests, one for workers over age 65 to 72, and one for workers under 65. The former reduces benefits by two dollars for each dollar of earnings above $5,000. The latter reduces benefits by two dollars for each dollar of earnings above $3,720. Thus, a worker can earn the exempt amount plus twice his or her benefit before all of the benefit is withheld.

The Advisory Council recommended that the earnings test for workers under age 65 be relaxed and made identical to that for workers over age 65 but that no other changes in the retirement test be made at this time. Six members of the thirteen on the Council supported a modified retirement test that I think is worthy of a carefully monitored demonstration or social experiment but should not be adopted now. I shall first present the reasons why the Council advocates retaining the retirement test, rather than removing it, and then turn to the alternative test that commanded the support of a sizable minority of the Council.

For decades the case for the retirement test has been uneasy. It was introduced at least in part because one of the original objectives of the Social Security System unabashedly was to encourage people to leave the labor force to make room for the unemployed. In addition, Social Security was portrayed as a program of earnings replacement, a collective measure to ease the decline in living standards that may accompany retirement when earnings cease. At least since 1942 the argument that Social Security should induce people to retire in order to make room for the unemployed has been invalid. American business and government can create additional jobs if the labor force increases. The only limit to the creation of additional jobs is the size of the labor force and the fact that inflationary pressures develop in some parts of the labor market before labor is fully employed in all. If older workers stayed in the labor force longer than they now do, we would reap the benefits of additional production and, at least during the transition to longer working lives, reduced inflationary pressures in labor markets.

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[1] Henry Aaron is Chairman of the Advisory Council on Social Security and a Senior Fellow at the Brookings Institution.

[2] The views expressed in this statement do not necessarily reflect those of Brookings staff members or the officers and trustees of the Brookings Institution.

The other argument for the retirement test—that Social Security is and should remain a system of earnings replacement, rather than an annuity—requires support. You have heard or will hear arguments about why Social Security should be converted into an annuity. You will hear how the elderly find themselves face-to-face with a fifty percent tax rate on earnings, imposed in addition to payroll and income taxes they must pay and that such taxes discourage work (remember that that is what they were originally intended to do). You will hear that the net earnings from such work would, if the earnings tax did not discourage it, contribute in an important way to the income needs of the elderly. You may hear that the earnings test encourages some elderly not to report earnings that they receive, and that the elderly should receive Social Security benefits because they have paid for them. I believe that there is some validity in each of these arguments, except the last (which is without merit, because the actuarial value of benefits that 65 year olds now can expect to receive after the retirement test ceases to operate—at age 72 today, age 70 after 1982—will far exceed the actuarial value of taxes paid for many years to come. But these arguments are outweighed by counter arguments.

Removing the retirement test entirely would increase the cost of Social Security $6 billion to $7 billion. Removing the retirement test only for those over age 65 would cost $2.6 billion in 1981 and $2.1 billion in 1982. In theory it would be possible to pay for such an increase in Social Security by curtailing low priority federal expenditures and divert the general revenues saved into the Social Security System. In practice the chances of pursuing this course are slim. So, as a practical matter, the cost of removing or liberalizing the retirement test would have to be met by increasing payroll taxes or reducing other Social Security benefits. Are the benefits worth the cost?

To answer that question, we have to specify the benefits. The most important would be the removal of a work disincentive affecting the aged. Anthony Pellechio estimated that removing the retirement test in 1972 would have increased the number of person years worked by the aged by only about ten percent. It is apparent that the lion's share of the cost of removing or liberalizing the retirement test would go to pay for extra benefits for aged who are working today and would continue to work after the retirement test was removed.

Who are these people? We know that they are earning at least $5,000 ($3,820 if under 65), because the retirement test does not apply below that amount. We know that a worker who has had average earnings during his career can receive $12,620 in earnings and benefits before any benefit is withheld ($10,080 if single). We know that such a worker will continue to receive some Social Security benefits until his earnings exceed $20,240 if he or she is married ($15,160 if single). In short, we know that the group that would benefit most from liberalizing or removing the retirement test is the fraction of the aged, much below half, that is financially much better off than average. If you have been forced to retire because of ill health, removing or liberalizing the retirement test will do nothing for you. If you are healthy and want to work part time, liberalizing or removing the retirement test may be of some value. But if you have your health and keep on working, particularly if you are a highly paid professional, like a doctor, a lawyer, an accountant, a real estate broker, or an insurance salesperson, then this proposal is a bonanza.

My point is not that doctors, lawyers, accountants, brokers, and salespeople are undeserving. I would like to see them receive more in Social Security, particularly if as a by-product it were possible to remove a disincentive to work. But in this year more than in most Congress should weigh the importance of providing higher benefits to the relatively well-to-do aged, most of whom work now and would continue to do so if the retirement test were ended, against other competing needs under the Social Security Act.

Let me indicate a few. By a simple revision of the social security benefit formula, Congress can assure that no social security beneficiary with long attachment to the labor force need have an income below the poverty threshold. It can increase the minimum benefit under the Supplemental Security Income Program so that no aged or disabled person need live in poverty. It can increase the grants for social services made to the states under Title XX of the Social Security Act, many of which are of direct value to the aged, especially for the homebound or frail elderly. I believe that if Congress wants to help the elderly, these are the elderly who deserve first consideration. At some future, it may be desirable to remove the retirement test in order to reap the benefits of improved work incentives for the aged. But that time, in my opinion, should come only after the much more pressing problems of the aged poor, disabled, and sick have been met. It should certainly not come at a time when public spending is under intense and justified pressure and higher priority uses of public funds than removal of the retirement test are casualties in the war against inflation.

I would like to add in passing that some so called liberalizations of the retirement test make work disincentives worse than they are under the current system. It is possible to liberalize the retirement test in at least three ways—by lowering the rate at which benefits are reduced when earnings exceed the exempt amount, by increasing the exempt amount, or by removing some part of the social security benefit from the retirement test. The first of these changes—lowering the rate at which benefits are reduced as earnings exceed the exempt amount—improves the work incentives for persons now affected by the test, but it also extends the effects of the earnings test to an increased number of workers. For example, among workers entitled to a benefit of $5,000 per year, those with earnings between $5,000 and $15,000 per year confront the fifty percent benefit reduction rate in the earnings test. If the fifty percent rate were reduced to say 33⅓ percent, then among workers entitled to a $5,000 per year benefit, all with earnings between $5,000 and $20,000 would face a 33⅓ percent benefit reduction rate. According to presently available estimates, such a change on balance would reduce work incentives. Increasing the exempt amount would raise the range over which the earnings test would operate and might improve work incentives marginally. It is not clear to me, however, why Congress at this time would elect to provide an increase in social security benefits only for those with earnings over $5,000 per year, and not for those with lower earnings or none at all.

The Advisory Council endorsed an increase in the exempt amount for workers under age 65 to bring it in line with the exempt amount for those age 65 or older. The Council supported such a change to do away with needless complexity, but there was no enthusiasm for the change and I personally oppose it.

In conclusion, I should like to call your attention to a proposal for liberalizing the earnings test by exempting a fraction of the social security benefit, a fraction that would increase as the worker aged. This proposal, advanced by Peter Diamond of MIT, would retain the earnings test for workers under the age of 65. At age 65, retirees would be entitled to 15 percent of their benefit free of the earnings test, while the remaining 85 percent would be subject to the test. The exempt fraction would rise from 15 percent at age 65 to 30 percent at age 66, 45 percent at age 67, 60 percent at age 68, 75 percent at age 69, and the complete benefit would be exempt at age 70. Six members of the Advisory Council endorsed this proposal and I believe that it deserves study, perhaps through a controlled demonstration or social experiment. The proposal suffers from the same distributional drawbacks as does elimination of the retirement test. None of the benefits of this change would accrue to workers earning just a bit more than the $5,000 exempt amount. All of the benefit would go to workers with earnings well over $5,000.[1] This drawback could be accepted if the plan has a greater effect on work incentives than would other changes in the earnings test. I cannot predict whether it would do so, and for that reason feel that it should be studied but not adopted.

Mr. BURTON. Thank you.

Mr. Ossofsky?

STATEMENT OF JACK OSSOFSKY

Mr. OSSOFSKY. Thank you, Mr. Chairman.

I welcome the opportunity to appear before you and would ask that my full testimony and its appendices be entered into the record. I would like to summarize my testimony and highlight some of its points.

I might add that I find myself in an unusual position at this table, and in unusual company for positions on this particular matter. Until the last recommendation made by Henry Aaron, I found myself in substantial agreement with his position and in support of his recommendations.

It might be useful to underscore that the National Council on Aging is an organization, a cross-section of America in many ways, epresenting business, labor, the professions working with older eople and older people themselves.

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[1] Consider a 68-year-old worker who is entitled to a benefit of $7,200. Under present law he can earn $5,000 before the earnings test comes into play, for a total family income of $12,200. When his earnings reach $13,640, his benefit would be reduced by $4,320 or 60 percent of his full benefit of $7,200; at that point family income would be at least $16,520. Under the Diamond plan, only those 68-year-old workers with benefits of $7,200 who earn more than $13,640, the point at which the benefit is reduced 60 percent, would benefit.

From that point of view, I think it adds some weight to the osition that our board has taken just earlier this week in asking ot for the elimination of the retirement test, but for continued iberalization of the test.

The test is indeed as old as social security itself and grew out of period in time in which the social security system and the Townend plan both emerged, a period of deep depression, in which the logan indeed was, work for youth, leisure for the aged.

Mr. BURTON. Ham and eggs every Wednesday.

Mr. OSSOFSKY. Ham and eggs. Certainly you are familiar with he slogan and the area from which it came.

The point is, of course, that the Townsend movement and indeed he social security movement did not offer very much security, not enough money to buy either ham or eggs. But the concept that it was based on has been one that has burdened the social security system, and indeed the nation, in a way.

The fact that this committee is trying to deal with this terribly complex matter is, I think, to your credit.

The heart of the problem, it seems to me, is that we do not have a national policy towards the aging or on behalf of the aging and on the issues of retirement.

Hence, on the one hand we are encouraging in a variety of ways, employment for older people—certainly a position in concert with the views of the National Council on the Aging—and on the other hand continuing a variety of programs which provide disincentives for that very work.

The social security system has no flat assertion about work and retirement other than the retirement test. It is clear that the history of the retirement test reflects a balancing of competing goals.

On the one hand, funds should be limited to those who have actually suffered a loss of earnings because of retirement. On the other hand, the system should interfere as little as possible with incentives to perform useful work.

This is obviously not an easy balancing act. Perhaps if it were, it would have been resolved some time ago.

As a result of the amendments of 1977, a beneficiary 65 to 72 may earn as much as $5,000 this year and lose $1 in benefits for every $2 earned in excess of that amount. By 1982 that limit will rise to $6,000 and apply only to those aged 65 to 70.

In that one step we have reduced the age of restriction by the retirement test, and increased the test modestly as well. Perhaps that is the pattern that ought to be followed at this time.

Though there are very few figures, perhaps no real figures, to reflect the impact of these most recent changes, we know that the impact of the retirement test in the past has been widespread.

In 1975, the latest year for which information is available, just over 1.3 million retired worker beneficiaries and 300,000 of their dependents had benefits reduced by about $2.7 billion because of the retirement test.

Without the test, these persons would have received $4.3 billion in benefits. These benefits reflect for the most part only beneficiaries between the ages of 65 and 72 because they have actually applied for the benefits.

Those under 65 and still working would not apply, knowing that to start with the retirement test would probably eliminate any benefits, and that later benefits would suffer an actuarial reduction.

Those over 65 tend to apply, even if no cash benefit is likely, because of their entitlement to medicare benefits. Of that group that I just mentioned, the 1.3 million retired worker beneficiaries, about a third lost all benefits. Two-thirds suffered some reduction of benefits.

A recent study of social security systems in over 100 other countries done by Kirkpatrick shows great variations in this area. Among non-Communist industrial countries, for example, 10 of the 20 systems imposed no work limitations whatever, 2 allowed no work, and 8 had partial work limitations.

I had occasion to discuss this subject just a few weeks ago with leaders of an organization serving or composed of older people around the world at a meeting of the International Federation on Aging.

Most of these leaders could not imagine that some older persons would want to stay in the job past normal retirement age. Their concept of the bargain between worker and retiree was a pension in exchange for your job—a more adequate response by society to the health needs, their housing needs and the like—on the assumption that people will as a matter of that social bargain retire—much more rigid than the present situation in our own country.

Indeed, our emphasis is to provide individual options for individual people. It seems to me the system needs to be strengthened in providing those kinds of options.

In a study commissioned by the National Council on the Aging a few years ago, a Harris poll of America's perceptions of the aging, we found 4 million older people who said they wanted to work, but could not get jobs.

The disincentive there was not the social security system. The disincentive was age discrimination, an inability to get a job.

Mr. BURTON. Was that before the age discrimination bill was passed?

Mr. OSSOFSKY. No. There was an age discrimination bill, but before the new amendments which increased it to age 70.

Mr. BURTON. All right.

Mr. OSSOFSKY. All of this reflects the complexity of the issue. Persuasive arguments can be indeed marshaled by those who seek total abolition of the retirement test and those who want to keep the test in its current form.

As I indicated, in our own meeting of our own board of directors this week, we reaffirmed our support for liberalization rather than elimination of the retirement test, and our full statement is appended to the record.

We do not believe that complete abolition of the test is either feasible or indeed desirable at this time. We do believe that continued liberalization of the test can add significantly to the incomes of millions of older people and to the productivity of the country, while not threatening the financial stability of the social security ystem. Completely abolishing the test would cost the trust fund everal billions of dollars.

In addition to those now affected by the test, many of the one illion to two million workers between 62 and 64 who are eligible r benefits but have not applied for them would begin to draw hose benefits.

Estimates of the cost of removing any earnings test, usually in he range of $4 billion to $6 billion, do not take into account ffsetting increases in receipts from persons who would be paying ncreased contributions to the trust funds, as well as income taxes.

Indeed, in this regard, I might say the subject is further compliated by the notion that is being discussed increasingly these days, nd that is of taxing social security benefits. That would further omplicate the value of the social security dollar.

Would the income tax be pretax dollars or posttax dollars? That ubject needs to be built into our decision about the earnings imitation test and indeed whether or not taxing those benefits nakes any sense at all.

Nonetheless, the cost would be large and the benefits would go argely to persons with substantial other income.

Jim Schulz of Brandeis estimated that if the test had been abolished in 1972, affected persons with family income over $10,000 would receive more than half the total gain. In 1972, by the way, $10,000 would represent about seven-eights of the median family income of all ages. A comparable figure for 1978 would be about $14,700.

Liberalizing the test is feasible financially, we believe, and it is important from a policy standpoint.

One simple reason for that, Mr. Chairman, is inflation. Social security benefits are adjusted for cost of living increases, and we urge your support for full retention of that provision. But very few private pensions are adjusted.

After just 10 years of retirement during a 7.5-percent inflation rate, a $5,000 a year pension would be worth about $2,400 in purchasing power, or 48 cents on the dollar.

More and more older persons are finding it necessary to supplement retirement income with earnings when they can find the jobs. Easing restrictions on their earnings would help immensely.

From society's standpoint, to the extent that the retirement test discourages older persons from working, liberalizing the test could help the country recoup billions of dollars of lost productivity.

Researchers have not been able to tell us how many persons are discouraged from working because of the retirement test. Our own evidence seems to lead to the cause being age discrimination rather than retirement test.

Mr. **Burton**. Discrimination at least up to the age of 70 by law, doesn't exist anymore.

Mr. **Ossofsky**. No, the law says it shouldn't be done. It doesn't mean it is not going on.

Mr. **Burton**. Well, people rob banks, but not every day.

Mr. **Ossofsky**. I wish I could feel so far, Mr. Chairman, that the intent of the law has been achieved by the country. I am a great supporter of the law, was one of its advocates. But I think we would delude ourselves to believe that all of its purposes have yet been achieved.

We have a long way to go. That doesn't mean we shouldn't have passed the law or indeed shouldn't be working towards elimination——

Mr. **Burton**. The only point I am making is I think the other study was kind of skewed. The study after the elimination of the mandatory 65 retirement could show it is the earnings offset that is a deterrent not the fact that they could not get a job.

Mr. **Ossofsky**. It is possible. We are trying to undertake another such national study right now which might provide that evidence, if we are able to get it funded and off the ground.

One of the byproducts of a study we have just completed of the Fortune; 1,000 personnel directors and chief executive officers showed a marked change in attitude about the capacities of older workers.

From that point of view, the change in social policy and acceptable response may be a result of the discussions around the age discrimination in employment act, and indeed if that is the case, that is all to the good.

There are some indications that earlier test liberalizations have induced a fairly large number of workers to increase their earnings. In economic times such as these, America can use such productivity.

Our organization has been energetically advocating increased employment opportunities for older people. We have fought vigorously against mandatory retirement. Our goal is not to strap older workers into the job saddle until they are too exhausted to continue, but to provide options for such workers.

They involve continued full employment, shared jobs, phased retirement, flextime schedules, and other arrangements.

We have yet to think through, as a society, the impact of these changes on our current concept of retirement as a fixed definable point in a person's work life. Until some consensus is derived, particularly in view of the associated costs, we believe that a complete end to the retirement test is premature.

May I add, too, that in my judgment it would fuel the current emerging perception that the aged are ripping off the Federal Treasury. You and I know that that is a lie.

You and I know that the elderly are barely getting 5.7 percent of the Federal allocation through general revenues towards aging program, and that the figures used to create the illusion of the elderly getting a great proportion of income comes from including in the Federal budget the social security trust fund.

It is worth repeating what I have said before to this committee and others, that if a private employer did what the Federal Government does in combining private pensions with corporate assets, we would throw that employer in jail, or at least give him a pretty hard time.

We don't do the same when the Federal Government uses the social security trust fund to show increases in the Federal budget as a whole or in Federal resources.

Mr. **Burton**. As done by Lyndon Johnson to finance the Vietnam war.

Mr. Ossofsky. Absolutely. But since the public does not perceive the reality yet—and we have an awfully big job to undertake in this regard—the timing of the total elimination of the retirement test when there are many other needs for older people would be of great concern to us.

It seems to me the issues that Henry Aaron has pointed out—the need to elevate the tapping out of the title XX program, and indeed to find out what portion of that money goes to older people, the strengthening of nutrition programs, social service programs generally, and the variety of other ways in which we could elevate the base of the oldest and the poorest of the elderly, the frail aged—might call for a better allocation of Federal resources at this time, rather than an exacerbation of the problems we are beginning to face. In the process, we ought to undertake some way of educating the public about the true resources available to older people, while liberalizing in a progressive step the requirement test.

Thank you for the opportunity to present this.

[The prepared statement of Mr. Ossofsky follows:]

PREPARED STATEMENT OF JACK OSSOFSKY, EXECUTIVE DIRECTOR, THE NATIONAL COUNCIL ON THE AGING, INC., WASHINGTON, D.C.

SOCIAL SECURITY RETIREMENT TEST: RETAIN IT AND UPDATE IT

Mr. Chairman and members of the Subcommittee, thank you for this opportunity to share with you the views of the National Council on the Aging on the social security retirement, or "earnings" test.

This is one of the most controversial issues in the current debate about social security, and NCOA commends the Subcommittee for scheduling these hearings. It is also an issue with which NCOA has been concerned for some time. Retirement income was one of the earliest priority areas of NCOA, from the time of its founding some 30 years ago. Our quarterly journal, "Aging and Work" (formerly "Industrial Gerontology"), has addressed the retirement test and related issues in great detail over the years.

The retirement test is as old as the social security system. The original 1935 law prohibited a person from receiving a benefit in any month in which he or she had wages from "regular employment." I think it is only fair to conclude that one of the original purposes of the test—indeed, of the Social Security Act itself—was to encourage older workers to leave their jobs, thus opening up opportunities for younger workers. The limit on earnings was also conceived as a disincentive for retired workers to return to the labor force.

It is worth noting, Mr. Chairman, that another pension scheme that received much attention in the 1930's—the Townsend Plan—incorporated an explicit prohibition on work by pensioners. In return for $200 a month, so the plan provided, beneficiaries renounced any further employment.

In the social security law, there was no such flat assertion of purpose. In fact, it seems clear that the history of the retirement test reflects an attempt by Congress to balance competing goals. On the one hand, funds should be limited to those who have actually suffered a loss of earnings because of retirement; on the other, the system should interfere as little as possible with incentives to perform useful work.

This is not an easy balancing act. A dozen times Congress has gone back and adjusted one incentive or the other, most recently in 1977. As a result of those amendments, beneficiaries aged 65-72 may earn as much as $5,000 in 1980, and lose $1 in benefits for every $2 in earnings above that. By 1982, that limit will rise to $6,000, and apply only to those aged 65-70.

Although there are no figures to reflect these most recent changes in the test, we do know that its impact in the past has been widespread. In 1975, the latest year for which information is available, just over 1.3 million retired-worker beneficiaries (and 300,000 of their dependents) had benefits reduced by about $2.7 billion because of the retirement test. Without the test, these persons would have received $4.3 billion in benefits. These figures reflect, for the most part, only beneficiaries between age 65 and 72, because they have actually applied for benefits. Those under 65 and still working would not apply, knowing the retirement test would probably eliminate any benefits, and that later benefits would suffer an actuarial reduction.

Those over 65 tend to apply, even if no cash benefit is likely, so that they can become eligible for Medicare.

A recent study of social security systems in over 100 other countries shows great variations in this area. Among non-Communist industrial countries, for example, 10 of the 20 systems imposed no work limitations, two allowed no work, and eight had partial work limitations.

I had the occasion to discuss this issue with leaders of aging organizations from around the world just last month at a meeting of the International Federation on Aging. Most of these leaders couldn't imagine that some older workers might want to stay on the job past normal retirement age. Their concept of the "bargain" between worker and retiree—your pension in exchange for your job—was much more rigid than even the present situation in the United States.

All of this, Mr. Chairman and members of the Subcommittee, is merely to say that this issue is a complex one. Persuasive arguments can be marshalled by those who seek complete abolition of the retirement test, and by those who want to keep the test in its current form or even tighten it.

In addressing the issue at its meeting earlier this week, NCOA's Board of Directors reaffirmed its support for liberalization, rather than elimination, of the earnings test. The full text of our policy statement on social security is attached to my statement as Appendix A.

NCOA does not believe that complete abolition of the test is either feasible or desirable at this time. However, we do believe that liberalizing the test can add significantly to the incomes of millions of older people, and to the productivity of the country, while not threatening the financial stability of the social security system.

Completely abolishing the retirement test would cost the trust funds several billions of dollars. In addition to those now affected by the test, many of the one to two million workers between 62 and 64, who are eligible for benefits but have not applied for them, would begin to draw benefits. Estimates of the cost of removing any earnings test—usually in the range of $4-$6 billion—do not take into account offsetting increases in receipts from persons who would be paying increased contributions to the trust funds (as well as income taxes).

But the cost would nonetheless be large, and the benefits would go largely to persons with substantial other income. Economist James Schulz of Brandeis University estimated that, if the test had been abolished in 1972, affected persons with family income over $10,000 would receive more than half the total gain. In 1972, by the way, $10,000 represented about ⅞ of the median family income for all ages. A comparable figure for 1978 would be about $14,700.

Professor Schulz also found, though, that the test could be liberalized significantly while channeling most of the increases to more moderate income older people. He sets out nine alternatives for liberalizing the test, all of which would give the greater share of benefit to those with family incomes under $10,000. And all but one of the alternatives would carry price tags less than half the cost of abolishing the test. The full text of that article is attached to my statement as Appendix B.

Liberalizing the test is feasible financially; NCOA believes it is important from a policy standpoint.

One simple reason for that, Mr. Chairman, is inflation. Social security benefits are adjusted for cost-of-living increases—and we urge your support for full retention of that provision—but very few private pensions are. After just ten years of retirement during 7½ percent inflation, a $5,000 pension would be worth about $2,400 in purchasing power, or just over 48 cents on the dollar. More and more older persons are finding it necessary to supplement retirement income with earnings, and easing restrictions on their earnings would help immensely.

From society's standpoint, to the extent that the retirement test discourages older persons from working, liberalizing the test could help the country recoup billions of dollars of lost productivity. Researchers have not been able to tell us how many persons are discouraged from working because of the retirement test, or how large a factor the test is in explaining low work force participation by older people. There are some indications that earlier test liberalizations have induced a fairly large number of workers to increase their earnings. In economic times such as these, America can use such productivity increases.

As the Chairman may know, NCOA has been an energetic advocate for increased employment opportunities for older people. We have fought vigorously against mandatory retirement. Our goal is not to strap older workers into the job saddle until they are too exhausted to continue, but to open up options for older people that involve continued full-time employment, shared jobs, phased retirement, "flexi-time" schedules and other arrangements.

Society has yet to think through the impact these kinds of changes will have on our current concept of "retirement" as a fixed, definable point in a person's work life. Until some consensus is derived, particularly in view of the associated costs, we believe that a complete end to the retirement test is premature. But the benefits of further liberalizing in the interim seem compelling, and we urge the Subcommittee to pursue such actions.

Thank you very much.

[See appendix 3, p. 174 for attachments to Mr. Ossofsky's prepared statement.]

Mr. BURTON. Mr. Penner?

STATEMENT OF RUDOLPH G. PENNER

Mr. PENNER. I would like to thank this subcommittee for the opportunity to testify. I request my full testimony be placed in the record.

Mr. BURTON. Without objection.

Mr. PENNER. I know of no element of the social security system that is more unpopular than the social security retirement test. The Congress has responded to this unpopularity by making it significantly more generous through time.

The recent increases in the generosity of the test have three important implications.

First, there is less of a disincentive to work now than under older versions of the test.

Second, the test can now be eliminated altogether at lower cost to the system.

Third, the elimination now would be of most benefit to the relatively affluent.

My prepared testimony gives two admittedly extreme examples which illustrates this last point.

It has sometimes been argued that the retirement test is so detrimental to work effort that the cost of removing it could be totally financed by the increased payroll and income tax payments received from those who would work more in its absence.

While the complexity of the test makes it extremely difficult to do empirical work on this issue, it is my judgment that the increase in work effort would fall far short of being sufficient to provide that amount of revenue.

My prepared testimony reviews some of the relevant literature. After reviewing that literature, I find it hard to believe that as much as $1 billion of the $2 billion in costs of removing the test in 1982 for the 65 to 69 group could be recouped from the tax proceeds derived from increased work effort.

Indeed, my best guess would be that the recoupment is far less than that, but let me assume for the sake of argument that the net cost of removing the test for that age group would be $1 billion in 1982 or half the gross cost.

There is absolutely no doubt that the test does some harm to economic efficiency, and it is certainly hard to argue that it is not inequitable. If it were costless, I would not hesitate to advocate its elimination, but it is not costless.

I take essentially the same position that my two colleagues do at the table. The important thing to ask is whether this is the best "good thing" we can do at the moment with $1 billion, in a time of general budget stringency, and in a time when the recent trustees report indicates the social security system faces particular difficulties.

Given that the test has recently been made very much more generous, I am afraid that I cannot give its removal very high priority.

I do believe that there are other inequities in the social security system that are more serious than those posed by the retirement test. An example of that is the discrimination between secondary workers, usually wives, who choose to work outside the home and those that choose to work in the home.

But before making any additions at all to the social security system, it is necessary to reflect on the budget problems facing the Federal Government over the next decade. There seems to be a great reluctance on the part of the taxpayer to see either income or payroll taxes increased. Yet there is broad consensus that defense spending be increased relative to GNP.

Defense now constitutes about a quarter of the budget. Payments to the elderly constitute another quarter of the budget. They are likely to grow even more rapidly than defense even without any changes in the law.

Mr. BURTON. Do you have the figures of what that proportion would be if we didn't have the unified budget, if we took out the trust fund?

Mr. PENNER. In very rough terms—total 1981 payments to the elderly are about $150 billion. I think about 80 percent of those are in the social security system, including medicare.

Mr. BURTON. So we are talking about general fund revenues, we are talking about a larger portion for defense and a very small portion for elderly programs.

Mr. PENNER. Yes; of course, how you do the accounting has nothing to do with the total tax burden.

Mr. BURTON. But one of the blessings of social security is at least the government cannot take use dollars to buy a missile. Not yet.

Mr. PENNER. That is not clear.

Mr. BURTON. They will think of a way.

Mr. PENNER. In any case, what I am really interested in is the total tax burden.

Ms. OAKAR. Mr. Chairman, may I ask a question.

Mr. BURTON. Ms. Oakar.

Ms. OAKAR. Mr. Chairman, I think the point he is making about accounting, and the point that Mr. Ossofsky made, are diametrically opposed to one another. I think we ought to state that very clearly for the record.

I think you are leaving out the fact that these people are paying into the system. It is a little different from other aspects of the budget in terms of the proportion of what they paid in. They are just getting back something they paid in for, which you would get for any insurance plan.

Mr. AARON. Not at the present time. At the present time the minimum return is about 2½ times what any currently retiring worker paid in, and the ratios go up to 6 and 7.

Ms. OAKAR. But what you are not taking into consideration—and you know you are not—is what the dollar value was worth when they paid into the system versus what it is worth today.

Mr. **Aaron**. I am taking that into account.

Ms. **Oakar**. No, you are not.

Mr. **Aaron**. Yes, I am. Inflation is built into the interest rate used in doing the calculation. Nobody has gotten a real interest rate return over the past 20 or 30 years of 6 or 7 percent. But that is the interest rate that is used in cumulating the value of benefits to be paid.

Mr. **Burton**. What has inflation been over the past 20 years?

Mr. **Aaron**. Much below 6 or 7 percent on an annual rate.

Ms. **Oakar**. But today what is it versus what they paid in?

Mr. **Aaron**. I am just saying——

Ms. **Oakar**. That is what all the authoritarians do when they say we are giving 25 percent to the elderly. They really don't get to the fine tuning of what the value of the dollar was worth, what the inflation rate was in 1940 and 1950 and 1960, versus what it is today. Unless you give the total picture, then you really are misleading the American public.

Mr. **Burton**. My big complaint is that I think it is outrageous to lump in trust fund moneys with other revenues. Trust fund moneys were paid for by people and their employers, and that cost them real wage increases. The employer had to put so much into a certain fund for a certain purpose. Now to treat that money as a general fund human resource expenditure is wrong. Lyndon Johnson put that fund in the budget for political reasons—to hide the cost of the increased military budget and the cost of the Vietnam War from the American people because it was a war they were never asked to pay for. We are all paying for it now. It is not your fault.

Mr. **Penner**. I was not trying to make any value judgment at all. I am being much more simpleminded. All I am saying is that if we spend $150 billion on the elderly, it has to come from somewhere. There is no big fund anywhere. That is the reality. That $150 billion will be somebody's taxes.

Mr. **Burton**. The money is in the taxes the elderly paid and the taxes their kids are paying to keep the system going. They aren't about to get a 6-percent return on those payroll taxes, especially after 1984.

Go ahead.

Mr. **Penner**. That is right. They are paying it. Maybe they enjoy paying it.

Mr. **Burton**. I don't think so.

Mr. **Penner**. I must confess, sir, I don't see a great willingness on the part of the American people now to pay more. I am talking about the overall general budget stringency we face. That really has nothing to do with accounting. It is there.

Ms. **Oakar**. Mr. Chairman, just one other point. Maybe a future discussion of this subcommittee should be whether the trust fund should be lumped in with the budget. Should we go back to what it was prior to the year that you mentioned, which it historically had been?

Mr. **Penner**. I recognize the feelings of those—we don't want to talk about that issue today very much.

Ms. **Oakar**. I think we have to, if you are going to make statements like that.

Mr. **Penner**. When we had the old administrative budget, and a different cash budget, the social security system was relatively small. I think it is a good point that it was possible to hide things by shuffling things around. I think we are far beyond that. It is just too big now, and I really don't think——

Mr. **Burton**. Congressman Goldwater and I have introduced a bill to take the airway trust funds out of the unified budget. In other words, we cannot use those moneys for anything. They would be held in trust.

I think it is the responsibility of the administration and the Congress to let the American people know where their income tax dollars are going.

Those tax dollars aren't going to help poor people. They are going to build a big military industrial machine. Those are just the facts of life. I am not criticizing you for it, but I think that we ought to restrict the buying power of social security funds. You see the slice of the pie and it shows the domestic spending, military spending.

If you ask the people the question, should we help the elderly—who are getting a nickel of your income tax, as against making people think they are getting a quarter—it would be a different answer.

Even with the quarter I don't think anyone has ever been attacked politically because they have done too much for the old people.

Ms. **Oakar**. Mr. Chairman——

Mr. **Burton**. Let him finish. You are getting the heat we usually reserve for Mr. Aaron. Go ahead.

Mr. **Penner**. The point I want to make has really nothing to do with accounting. It is simply that there is this $150 billion, however you want to account for it, that is going to grow more rapidly in the future, and probably grow more rapidly than defense.

The growth in this will be pushed by two forces. First, the elderly population is growing about twice as fast as the total population. Second, the social security structure promises each successive cohort of retirees average benefits that will grow faster than the inflation rate and indeed probably faster than the average rate just of the working population.

Thus, we have half of what is commonly called the budget that is virtually certain to grow significantly faster than the GNP at a time when the population doesn't want higher taxes relative to GNP, and when we can no longer afford the massive deficits that have been with us since the late 1960's.

Therefore, I do not see this as a time to contemplate additions to social security benefits, but rather it is a time to consider equitable reforms that would reduce their rate of growth in the long run.

I should emphasize that there is no economic need to reduce the real value of average benefits below current levels and, indeed, there is room for considerable growth in the generosity of the system assuming that the economy again begins to grow.

My doubt involves the question whether there is room for the very rapid growth in average real benefits that is now provided automatically by the indexing methods used by current law.

My own belief is that in 1977 we adopted an indexing system for the determination of initial benefits that is too generous while we are not generous enough to the already retired.

The indexing system says that until you retire, the benefits that you are accumulating will share in the economic growth of the Nation because they are indexed to wage rates.

As soon as you retire, however, you no longer share in the benefits of growth because then your benefits are indexed only to the rate of growth of prices.

I would much prefer a system in which all prospective and current benefits were indexed to prices with the Congress then able to decide from time to time how some share in the benefits from economic growth should be divided between prospective retirees and those who are already retired, or perhaps used to cure inequities, such as those posed by the inequitable treatment of spouses who both work and those posed by the retirement test.

None of this implies that we should rule out the absolute reduction of benefits where that can be justified either because of changing economic and demographic conditions or because we have created other programs that duplicate certain elements of the social security system.

There is a long list of options that deserve consideration, in my view, but which admittedly do not have any support in the current Congress.

Thank you.

[The prepared statement of Mr. Penner follows:]

PREPARED STATEMENT OF RUDOLPH G. PENNER,* DIRECTOR OF TAX POLICY STUDIES, AMERICAN ENTERPRISE INSTITUTE

THE SOCIAL SECURITY RETIREMENT TEST

I would like to thank this committee for the opportunity to testify. The views presented are my own personal views and do not necessarily reflect the views of the staff, advisory panels, officers, or trustees of the American Enterprise Institute.

I know of no element of the social security system that is more unpopular than the social security retirement test. Although the social security retirement system has many characteristics that make it differ from an annuity system, many participants do, nevertheless, regard it as an annuity and feel that since they paid in, they merit benefits whether or not they continue to work past the age at which they are eligible for social security. The perceived inequity is heightened by the fact that investment and other pension income does not reduce social security benefits, but wage income may.

The retirement test can only be justified if social security is regarded rather narrowly as a system that provides insurance solely against a loss of earnings due to disability or retirement. This has in fact been the underlying philosophy of the system since its inception, but it is not surprising that those elderly who would like to work past the eligibility age find this philosophy hard to accept.

The Congress has responded to the unpopularity of the retirement test by making it significantly more generous over time. In 1982, the first $6,000 of earnings will be exempt for those aged 65–69 and benefits will be reduced 50 cents for every dollar earned above the exempt amount. The test will not apply to those aged 70 and above. For those aged 62 through 64, the exempt amount in 1982 will be determined by average wage growth between now and then, but is estimated to be about $4,440. The recent increases in the generosity of the test have three important implications. First, there is less of a disincentive to work than in the past. Second, the test can now be eliminated altogether at a lower cost to the system. For 1982, the cost of removing it for those aged 65–69 has been estimated at slightly more than $2 billion. Third, the elimination would be of most benefit to the relatively affluent.

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* The views presented in this testimony are the author's and do not necessarily reflect the views of the staff, advisory panels, officers, or trustees of the American Enterprise Institute.

To illustrate the last point, let us consider two extreme cases. First consider a man aged 65, with a non-working spouse who is considering retirement in 1982 and who has earned at least the maximum covered earnings amount through his working life. Assume further that he has the opportunity to continue working at a salary of $30,000 per year. At that rate under current law, the couple would lose their entire tax-free benefits of $11,280 per year.[1] If the retirement test were removed, the couple would receive this benefit while the man continued working, and if the couple has no other income, the improvement is equivalent to an increase of about 40 percent in their after-tax income with the exact amount depending on their deductions and the other factors which determine their tax bracket.

At the other extreme, imagine a single man who has worked full-time at the minimum wage throughout his life and has the opportunity to continue doing so at age 65. In 1982, assume the minimum wage is $3.35 per hour. His annual income would then be $6,972 assuming a work year of 2,080 hours. It clearly pays him to apply for benefits at age 65 even if he continues working, because he would lose only $486 out of total benefits of $3,960. If the test were removed, he would get the $486 back or the equivalent of about a 5 percent increase in after-tax income.

The fact that the affluent would benefit most from the removal of the test does not, of course, provide a prima facie case for keeping the test. Generally, the social security system discriminates against the affluent and with the removal of the retirement test they would still get a lower rate of return on their contributions than would the low income worker.

Effects of the retirement test on work effort

It has sometimes been argued that the retirement test is so detrimental to work effort that the cost of removing it could be totally financed by the increased payroll and income tax payments received from those who would work more in its absence. While the complexity of the test makes it extremely difficult to do empirical work on this issue, it is my judgment that the increase in work effort would fall far short of being sufficient that the increase in work effort would fall far short of being sufficient to provide that amount of revenue.

The effects of the test depend crucially on what is assumed about the characteristics of labor markets for the elderly and we know remarkably little about that issue. If those markets were totally flexible in the sense that an elderly person could freely choose how many hours to work at a fixed wage rate, it is hard to argue that the test has much effect on work effort. In 1975, 83 percent of those aged 65–69 were either completely retired or earned less than the then exempt amount of $2,520. With complete flexibility, any of these people could have chosen to work at least up to the exempt amount before the retirement test had any impact on them and the fact that they chose not to would mean, under this extreme assumption, that the test had no effect on their decision to retire fully or partially. Another 7.7 percent of this age group worked enough to lose all benefits. The removal of the test would have provided them with a lump-sum windfall and both economic theory and considerable empirical work indicate that such lump sum payments reduce work effort with the largest effect being on the secondary workers in couples where both work. For the remaining 9.3 percent of the 65–69 age group who were earning above the exempt amount without losing all of their benefits, the available evidence suggests that their work effort is reduced by the retirement test,[2] but clearly the net impact of the test's removal on the work effort of the entire population could not be very large given the extreme assumptions of this analysis. Under the most favorable of conditions the increased payroll and income taxes resulting from the removal of the test would pay less than 20 percent of the cost of removing it and it is my judgment that the reflow would be less than one-half of this amount.

But the above analysis assumes that the elderly person has completely free choice over the number of hours worked at a given wage rate. Very probably most do not have this choice. Many have only the choice between full-time work and complete retirement while others may have the choice between full-time work at one wage and part-time work at a lower wage. Under these conditions, we can no longer be sure that those choosing complete retirement or earnings below the exempt amount would not have chosen full-time work or at least a greater number of work hours in the absence of the test.

Of course, not all of the population in the 65–69 age group are available for work. A vast majority say that they have retired for health reasons, but some have speculated that this is said only to provide a "socially acceptable" excuse for retirement.[3] Many others clearly enjoy the opportunity to retire while in good health and they, too, would not be affected by the removal of the test.

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[1] See "Reports of the 1979 Advisory Council on Social Security," table 1, p. 59.

[2] For a review of the literature, see Josephine G. Gordon and Robert N. Schoeplein, "Tax Impact from Regal of the Retirement Earnings Test," SSA/OS, Apr. 2, 1977, a paper done for the 1979 Advisory Council on Social Security.

It is common for students of the issue to investigate rather arbitrarily the implications of 10 percent of the completely retired choosing instead to continue work in the absence of the test. Under the circumstances about 80 percent of the cost of removing the test would be recouped in increased payroll and income taxes,[4] if there was no negative impact on the work opportunities and wage rates available to the rest of the population. If only 5 percent of the fully retired chose to continue to work about one-half of the cost of removing the test would be recouped.

My own inclination is to assume that very few of the completely retired would have chosen to work in the absence of the test. If there was a large population of potential workers out there, I would expect more of a market to have already developed that was structured around the current retirement test. That is to say, potential employers would be willing to structure part-time jobs for the elderly that allowed them to earn up to the current exempt amount. Such a part-time market exists that is structured around the needs of students, but I am unable to find any evidence that a similar market exists for the elderly. That, of course does not mean that it does not exist. More generally, it must be admitted that the evidence on the work effort of the elderly may be obscured by the fact that there is a powerful incentive to cheat on the system and not to declare any earnings that would reduce benefits.

Nevertheless I find it very hard to believe that as much as one-half of the costs of removing the test could be recouped from the tax proceeds derived from increased work effort. Indeed my best guess would be that the reflow is far less than that.

Policy implications

Let us assume for the sake of argument that the net cost of removing the test for the 65–69 age group would be $1 billion in 1982. (The possibility of removing it for the 62–64 age group is seldom discussed because the cost would be very large in the short-run. In the long-run, this cost would be offset because future benefits would be reduced actuarilly.) There is no doubt that the retirement test does some harm to economic efficiency, and it is hard to argue that it is not inequitable. If it were costless, I would not hesitate to advocate its elimination, but it is not costless and one has to ask whether this is the best "good thing" that can be done with one billion dollars in a time of general budget stringency and in a time when the recent Trustees' Report indicates that the social security system faces particular difficulties.

Given that the test has recently been made very much more generous, I am afraid that I cannot give its removal very high priority. I do believe that there are other inequities in the social security system that are more serious than those posed by the retirement test. Foremost among them is the discrimination between secondary workers—usually wives—who choose to work outside the home and those who work in the home. While the inequity could be resolved by reducing the benefits of the stay-at-home wife, this does not seem plausible politically and any acceptable solution is likely to be costly.

But before making any additions at all to the social security system, it is necessary to reflect on the budget problems facing the Federal government over the next decade. There is a great reluctance on the part of the taxpayer to see either income or payroll taxes increased. Yet, there is a broad consensus that defense spending be increased relative to GNP. Defense now constitutes about one-quarter of the budget. Payments to the elderly constitute another quarter of the budget and they are likely to grow even more rapidly than defense even without any changes in the law. This growth is due to two forces. First, the elderly population is growing about twice as fast as the total population and second, the social security structure promises each successive cohort of retirees average benefits that will grow faster than the inflation rate and indeed, probably faster that the average wages of the working population.

Thus we have half the budget that is virtually certain to grow significantly faster than the GNP at a time when the populace doesn't want higher taxes relative to GNP and when we can no longer afford the massive deficits that have been with us since the late 1960's.

Unless we are willing to take draconian action with respect to the remaining half of the budget, much of which is fixed contractually (interest on the debt, mortgage subsidies, etc.) I do not see this as a time to contemplate additions to social security benefits, but rather it is a time to consider equitable reforms that would reduce their rate of growth in the long run. I should emphasize that there is no economic need to reduce the real value of average benefits below current levels and indeed, there is room for considerable growth in the generosity of the system assuming that the economy again begins to grow. My doubt involves the question whether there is room for the very rapid growth in average real benefits that is now provided automatically by the indexing methods used by current law.

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[3] Michael J. Boskin, "Social Security and Retirement Decisions," Economic Inquiry, January 1977, pp. 3–4.

[4] Gordon and Schoeplein, op. cit., p. 21.

My own belief is that in 1977 we adopted an indexing system for the determination of initial benefits that is too generous while we are not generous enough to the already retired. The indexing system says that until you retire the benefits that you are accumulating will share in the economic growth of the nation because they are indexed to wage rates. As soon as you retire, however, you no longer share in the benefits of growth because then your benefits are indexed only to the rate of growth of prices. I would much prefer a system in which all prospective and current benefits were indexed to prices with the Congress then able to decide from time to time how some share in the benefits from economic growth should be divided between prospective retirees and those who are already retired, or perhaps used to cure inequities such as those posed by the inequitable treatment of spouses who both work and those posed by the retirement test.

None of this implies that we should rule out the absolute reduction of benefits where that can be justified either because of changing economic and demographic conditions or because we have created other programs that duplicate certain elements of the social security system. There is a long list of options that deserve consideration in my view, but which admittedly do not have any support in the current Congress. They involve items such as:

One. Eliminating the student benefits under social security because of the host of new Federal programs providing benefits to students.

Two. Eliminating the minimum benefit which has been made obsolete for the needy by SSI and is now mainly relevant to retired civil servants.

Three. Eliminating the death benefit and replacing it with a more generous benefit for the needy under SSI.

Four. Extending the retirement age because of significant increase in life expectancy.

Five. Taxing one-half of the benefits given the generous tax treatment of the elderly who have moderate or low incomes.

In addition, reduced payroll taxes would be possible if the system was expanded to include Federal and State and local employees now excluded. This option may be somewhat more political plausible that the others discussed above.

With a series of cost-saving reforms, we would have the resources to improve the equity of the current system while reducing tax burdens. However, I recognize the difficulty of contemplating such reforms in part because the overall social security system is one of the most popular government programs ever created and there is a great reluctance to meddle with it in any way that reduces even the most irrational benefit. But without some cost saving one has to ask whether the system will remain popular with younger workers. It will face a crisis in the early 21st century when those born in the baby booms of the 1940s and 1950s begin to retire. It is not too early to plan for weathering this storm.

Mr. BURTON. Thank you.

I would like to ask, when we are dealing with the $5,000 figure, is that net or gross; in other words, what you can earn.

Mr. AARON. For the aged it is the same thing because they are typically not going to be subject to tax on the first $5,000 of earnings. It is a gross figure, though. It refers to the total earnings.

Mr. BURTON. And those earnings are tax-exempt. The first $5,000, I guess in most places is exempt from sales tax, income tax, payroll tax. Excuse me. State income tax, I meant. I guess in our State, with $5,000, you don't need to pay State income tax.

Mr. AARON. I don't know about California.

Mr. BURTON. No federal income tax.

Mr. AARON. I don't think so.

Mr. BURTON. And no payroll deduction tax.

Mr. AARON. That is not quite right for federal. The zero bracket amount plus two exemptions, which is what a single person would say, would take you up to $4,300. So they would pay tax on $700 of those earnings, under Federal income tax.

Mr. BURTON. How would a single person get two exemptions?

Mr. AARON. Two exemptions for the aged.

Mr. BURTON. Right.

Mr. OSSOFSKY. That is assuming the earnings are only $5,000, of course, and you have to deduct the social security contribution.

Mr. BURTON. That is what I was asking. What is the social security contribution on $5,000, if any?

Mr. AARON. About $300.

Mr. BURTON. About $300, and then tax on $700, which would be split, I guess.

Mr. OSSOFSKY. If you don't have much, that counts.

Mr. BURTON. I know. A very important element if you are out in the desert for 3 days.

Mr. Penner, you were talking about the cost of living increase that you would have the same for—the point I think was the second last point you made.

Mr. PENNER. Yes. Well, it is not one of those easy things to explain in the social security system. Basically, the benefit formula, as you know, gives a lower replacement rate to people who earned a higher income through their lifetime.

If we didn't adjust that formula at all, both inflation and growth in real standards of living would tend to lower the replacement rate. I think it fairly obvious that we don't want inflation to lower the replacement rate. It would actually hurt people's real standard of living.

So, we certainly, should adjust, the formula to prevent inflation from lowering replacement rates. But we went beyond that in 1977. We said neither inflation nor increases in the general living standard of the populace should lower inflation rates.

Or, in other words, up to the day you retire, we said we are going to automatically adjust this thing so that people keep up with the general standard of living of the economy, and that seems to me to be a reasonable value judgment to make.

On the other hand, though, we said after you retire, that doesn't go anymore. After you retire, all we promise to do is keep you up so that you are held harmless by inflation, and you have no automatic right at least to have your living standard increased along with the living standard of the rest of the population.

Now I think given the long-run outlook of the fund, it seems to me that we cannot afford to keep everybody up with the average standard of living. It would seem to me to be a more equitable for the automatic part of the adjustment, just to keep everybody protected from inflation, saying that we are not going to let price increases reduce your relative standard of living. But then, I would leave up to the discretion of Congress how you give away the rewards from economic growth. All of this assumes we are going to have some economic growth. If we do not, we are in big trouble.

Mr. BURTON. So you would have an add-on increase, cost of living increase and if there is a productivity increase.

Mr. PENNER. If there is productivity growth then there would be three options for using that reward. It could be used to increase prospective benefits. It could be used to increase the living status of those people who have been retired a long time, or to make reforms in the system. Certainly one of my first choices would be to eliminate the retirement test, if I thought we could afford it, or to cure the many other inequities in the system.

Mr. **Burton**. So your problem with the retirement test is not the fact that somebody making a lot of money might end up getting more than somebody else, but the fact of the fiscal restraints on the system.

Mr. **Penner**. Yes. I think it is a difficult time and I do not see any easing of that difficulty over the next 10 years. It really gets bad again at the beginning of the 21st century.

Mr. **Burton**. Gerry?

Ms. **Ferraro**. I have no questions.

Mr. **Burton**. Ms. Oakar.

Ms. **Oakar**. Thank you, Mr. Chairman.

On the line of questioning of the chairman, you feel the system is inequitable by having the earnings test, but prejudice we should not measure in dollars. I mean, we cannot eliminate prejudice if it costs money, is that what you are saying?

Mr. **Penner**. No, I am not saying that at all. I am saying that you can find——

Ms. **Oakar**. You said there is no doubt that it is inequitable.

Mr. **Penner**. That is right. All I am saying is that there are inequities that are much more serious and which should take priority. I am saying it is marginally inequitable, if you like.

Ms. **Oakar**. One of the things that I think is of interest is that while so many people will project it is going to cost more, they have not taken into consideration the fact that there are some benefits that will be reduced, for example, people are having fewer children. If people would work longer because of the elimination of age discrimination, they might not elect to take advantage of this possible future benefit, et cetera. So I do not think we are really adding up all the kinds of projections, you know, properly about the system. I am not so positive that it is going to cost so much more in the 21st century.

Mr. Aaron, on page 5 of your testimony you somewhat implied that only married workers who make above the $20,000 level in earnings will benefit from the repeal.

Mr. **Aaron**. I certainly did not mean to imply that. Those statistics referred to workers with average earnings. The full benefit of removing the retirement test would be enjoyed only by those whose earnings exceeded that amount. Others with earnings lower would receive partial benefit.

Ms. **Oakar**. There are 1 million people in the group below $20,000. I am glad you clarified that for the record.

Mr. Ossofsky, I am frankly a little surprised at the position of the National Council. What I think you and Mr. Aaron both did, if you do not mind my saying so, was pit domestic programs against the elimination of the earnings test. We all know that if you did not have the earnings test that if it is true that it cost $1 billion, they never used that for domestic programs. Why can we not increase title XX and all the very eloquent things you said in the testimony? Why does it always have to reflect the problems of the social security system because you, on appendix A, which you did ot read, gave a very interesting statistic. You said according to he Harris study social security benefits were a current source of ncome to 89 percent of those over 65 and the largest source of ncome to the majority of the older people. Well, does that not uggest to you that these people might, if age discrimination were liminated, might want to work and not only might want to work ut might need to work?

Mr. **Ossofsky**. Absolutely. I think we need to be consistent in hat and I do not think that we are. I think we are very ambivalent in that and the Congress is very ambivalent in that and reflects an ambivalence throughout the country. We are suggesting that we continue to move in the direction of continued liberalization and from the point of view of how we use even social security funds, what elbow room we have to use them for the most needy of the aged. You are right, this is a somewhat different position than you might have anticipated from us at another period of time. It is a change in position on my own behalf, I might say.

Ms. **Oakar**. It makes me wonder. I have a lot of respect for the National Council, but who is on your board?

Mr. **Ossofsky**. It should give you a good notion that we indeed reflect a good cross-section of Americans' interests on our board.

Ms. **Oakar**. Do you have people over 65?

Mr. **Ossofsky**. Of course, and into their 70's and 80's.

Mr. **Burton**. They already have an earnings limit.

Mr. **Ossofsky**. The founder of our organization will be 90 this year. I will not give you the age of our new president, but it is well over 70, as is the current president. You would make a mistake if you judge this as seeking the point of view only that one favors the aged only by favoring this position. One can favor the aged and seek a balanced proportionate growth in the programs and prioritizing where we put the resources we have.

Ms. **Oakar**. You both make a case that the more affluent would benefit and your own statistics seem to show, if you are going to say that Harris is accurate, that the majority of older people will have this as their major source of income. So how is it that you can come up with a view——

Mr. **Ossofsky**. But they are not working. The reason that is so is because they are not working. I do not accept the notion that the reason they are not working is the dominance of the retirement test in itself.

Mr. **Burton**. It was a mandatory 65 retirement that was the issue. It had to be a big piece of that, was it not?

Mr. **Ossofsky**. Yes, it was.

Mr. **Burton**. Then the case is closed. That was a big piece of their ability to work. Now at least the elderly hopefully have the legal ability to work. We could then find out if the earnings test is a disincentive or not.

Mr. **Ossofsky**. Fine, I do not oppose doing that. I suggest that the most logical way to do that is to continue to liberalize the retirement test without taking the position of eliminating it. I will admit to you that it is sometimes more difficult to take a moderate position than an extreme position. I am rarely in the role of taking a moderate position in these kinds of issues, nor in the company of these two gentlemen.

Ms. **Ferraro**. When I commented on the opening statement I was concerned that it might seem as if I was against the aging by taking the same position that you have taken with reference to this particular earnings test.

Mr. **Ossofsky**. I dare say the National Council on the Aging which has been around for 30 years, and I have been in the field of aging for that long in a variety of roles, could scarcely be accused of that with any examination of our record. The fact of the matter is that the positions that we take on public policy come in to us with recommendations from our work in the field, from the thousands of people in direct contact with older people and from older people. They are debated within our board.

Ms. **Oakar**. You really feel that older people do not want to have this eliminated? Really? Is that what you are saying?

Mr. **Ossofsky**. I did not say that. I said that a cross-section of those concerned with the welfare of the aged, which includes older people. Now older people are not a homogeneous group.

Ms. **Oakar**. I want to know if you feel that older people in general—forget about other age groups, because I think it is about time the older people have something to say about their own destinies instead of all the theoreticians on occasions. Do you think older people do not want this eliminated, the majority?

Mr. **Ossofsky**. I think most older people do. It is an issue I have heard from older people for many years.

Ms. **Oakar**. That is what I want to know.

Mr. **Ossofsky**. But that is not the full answer.

Ms. **Oakar**. Let me pursue this for one second. Even if you gentlemen were correct, and I do not agree that you are, that the people who would benefit more, be more likely to benefit from this change, would be those who are in a higher income bracket, although you gave the statistic of $10,000, which I do not consider an awful lot of money, even if that were true, is there not something to be said about an issue that is related to prejudice? That is what it is. It really does come down to that. Inequitability relates to prejudice.

Mr. **Ossofsky**. Miss Oakar, you raise this as if it is the only option before us. If we present this to older people in terms of who should be helped most, where should the social security improvements come next, I am not so sure, and given some sense, and they are aware of the issues in social security and the pressures on the country, I am not so sure that improving the options or improving benefits for the poor or providing other resources through the social security trust fund, that they would not be for that.

Ms. **Oakar**. I introduced six bills related toward inequities toward women. Why are we always pitting issues that relate to inequity against each other? Why are you not acting in terms of the ideal with the fact that our national priorities ought to deal with the ideal? What are they in terms of where our budget goes? They are sure not for eliminating prejudice in this country.

Mr. **Ossofsky**. I do not want to put in the record a lifetime of speeches that call for that. I do suggest to you, however, on this specific subject matter before this committee I present to you what I think is a constructive step to deal with this issue. It moves in the right direction, and it still does not bind us from making other changes which have greater priority for the most vulnerable of the aged.

Ms. Oakar. I do not question your sincerity or intent or what you represent, because I happen to respect what you represent. I do not agree with you on this particular issue, and I have to say I am somewhat surprised about it. That is not to attack anybody's veracity.

I will be happy to yield.

Ms. Ferraro. I wanted to make a comment with reference to what you are discussing now. Hart Associates has done a survey for the National Commission on Social Security. When they asked what the elderly thought was the biggest disadvantage of the social security system, only 2 percent said the earnings test was a disadvantage, and 39 percent said inadequacy of benefits was a disadvantage. I think that is probably where you are going and where I am attempting to go as well.

Thank you for yielding.

Ms. Oakar. I appreciate that, but the point is, if they talk about higher benefits, which I think you mentioned Mr. Aaron, which I agree with, no one has mentioned how we pay for that. All of a sudden that is not an issue in terms of how you pay for that.

Mr. Aaron. I commend you to the Advisory Council report's section on that issue. You can skip the one on taxation of benefits——

Ms. Oakar. I would love to.

Mr. Aaron [continuing]. Which presents an alternative benefit formula that accomplishes this and comes out at no net additional cost. As you may quickly infer, somebody has to lose if somebody gains. The gainers are long-term low-wage workers and the losers are very short-term workers in the system.

Mr. Burton. If I could inject, doesn't your position assume that there was $1 billion in benefits and only $1 billion in benefits, and if you had your choice of helping the people in this category by eliminating the earnings test or helping some people worse off, then you would help those worse off? You are not talking about the policy of it. You are just saying if there is only so much to chop up there are other priorities before this?

Mr. Ossofsky. Precisely. Let me say, Mr. Chairman, that in that role I am certainly not at variance with other fighters for improvements in the social security like the labor movement.

Mr. Burton. What if there is a choice between doing this or doing nothing? In other words, this is third on the priorities but the most doable?

Mr. Ossofsky. Well, given that reality, I suppose against doing nothing, which I really do not believe is our circumstance, I would be inclined to move in this direction. Yes, if those were my only options I would be prepared to modify my stance. I would hope that we are not in that situation. Let me make it clear, I am not opposed on this issue.

Mr. Burton. No. I think you answered the question.

Mr. Ossofsky. By the way, on one other item that was raised before, I think it is useful for the record to underscore that from general Federal revenues we are investing I think 5.7 percent in aging services and benefits, leaving out the social security trust fund. Even when we add the operations of Government, which includes military pensions and civil service pensions, we are dealing with perhaps 7 percent of general revenues. We are talking here about 1 percent of the population, a disproportionate number of home need services in our country. I am not concerned that we are overinvesting in the aged in our country. Certainly social security taxes have an impact on our whole economy. But as far as the public is concerned, a Lou Harris poll released a week or so ago showed that 71 percent of the public responding that they are prepared to maintain social security benefits, to increase the protection of older people, and 64 percent to increase social security taxes to maintain social security benefits for the future, seeing their own future being related to what happens to older people today.

Mr. BURTON. I do not think they have seen the impact of social security increases coming down the pike.

Mr. OSSOFSKY. We are talking about where they see it now. The notion that people do not differentiate between taxes generally and the social security tax is in error. People are unhappy about the increase in taxes generally, but when push comes to shove, and given that option, I guess the most negative way to put it, among a lot of unhappiness about taxes, social security still has the support of the public.

Mr. BURTON. I do not think there is a difference. I happen to think the social security tax is the most regressive tax going—especially by the time it hits the limits under that finance law that I am privileged to have voted against. We are going to see different results in a poll like that. That is why I favor the concept of moving to the one-third, one-third, and one-third situation.

Mr. OSSOFSKY. I do, too.

Ms. OAKAR. Maybe one of the things we ought to look into futuristically is how we invest social security trust funds. Everyone seems to think something is sacred about the way we do it now. I am not sure that is true. Other pension plans are creative. Why are we not? I know we have some scholars here. I do not know if that was in your report or not, but I do not think it was.

Thank you, Mr. Chairman.

Mr. BURTON. Mr. Hopkins.

Mr. HOPKINS. No questions.

Mr. BURTON. Thank you very much.

The last panel will be James Hacking, assistant legislative counsel, National Retired Teachers Association and AARP, Dr. Anthony Pellechio, University of Rochester and National Bureau of Economic Research, and Thomas Woodruff, executive director, President's Commission on Pension Policy.

Gentlemen, in the interest of time, I wonder if we could make your complete statements a part of the record and you could orally summarize them now. I am prepared to stay here through lunch. But you can feel free to go and come back as we are going to have to be on the floor for some very meaningful discussions.

Mr. Woodruff, we will make your full statement a part of the record. You may highlight it.

PANEL FOR ELIMINATING THE EARNINGS TEST, CONSISTING OF THOMAS C. WOODRUFF, EXECUTIVE DIRECTOR, PRESIDENT'S COMMISSION ON PENSION POLICY; JAMES HACKING, ASSISTANT LEGISLATIVE COUNSEL, NATIONAL RETIRED TEACHERS ASSOCIATION/AMERICAN ASSOCIATION OF RETIRED PERSONS (NRTA/AARP); AND ANTHONY J. PELLECHIO, PH. D., UNIVERSITY OF ROCHESTER AND NATIONAL BUREAU OF ECONOMIC RESEARCH

STATEMENT OF THOMAS C. WOODRUFF

Mr. WOODRUFF. Thank you, Mr. Chairman. I appreciate the opportunity to testify today on the issue of the earnings test and the importance of encouraging older employees to remain in the labor force.

As you know, the President's Commission on Pension Policy was established out of a recognition that there are some significant problems ahead for pensions. The Commission is developing long-range retirement policies to deal with these problems.

Our work focuses on the central question of how to provide older Americans with an adequate level of income in their later years. While employment is not generally considered a pension issue, the Commission believes it will become increasingly important in the retirement income context as the Nation's population ages.

We are all aware that the country's retirement income resources, both public and private, are straining to meet current benefit payments. We can expect that, unless steps are taken to alleviate this situation, even more pressure will be exerted on these resources in the future.

By 1975 social security assumed payment of approximately 60 percent of all retirement and survivor benefits. State and local government plans and private plans lag far behind. A poll sponsored by the Commission indicates that approximately 58 percent of all workers expect social security to be their primary source of retirement income. And, a joint survey by the Department of Labor and the Social Security Administration indicates that in 1979, only 51 percent full time of workers in private industry were covered by a pension. Half of those workers are vested and therefore eligible for a pension benefit from their current employer.

The Commission endorses the current role of social security in providing a minimum floor of protection for workers and their families. But, we are very concerned about the obvious increase in dependency on pay-as-you-go retirement systems. The 1980 annual report of the social security trust funds released last week reinforces the Commission's conclusion that this Nation may face substantial risks by increasing dependence on pay-as-you-go systems.

The mounting pressures on social security brought about by demands for increased pension benefits, high rates of inflation, and a large aged population which lives longer in retirement, make it essential that policymakers examine every option for providing additional income resources to the elderly.

The Commission feels strongly that one way of relieving the intergenerational dependence and financial strain on our retirement systems would be to encourage continued labor-force participation.

Over the last several decades, an increasing number of males in the 65-plus, 60 to 64, and 55 to 59 age categories have retired. Although early retirement under social security was provided for males in 1961, the largest drop in labor force participation in the 60 to 64 age category occurred in the 1970's. In 1979, only 62 percent of this group were in the labor force, compared with 75 percent in 1970 and 78 percent in 1960. The proportion of women aged 60 to 64 also dropped in the 1970's, although still above the 1960 and 1950 figures. Older women have been experiencing a counter-trend of increased participation.

The Commission recognizes there are many factors which enter into the retirement decision, including: health status; anticipated retirement income; and relationship of the worker to the job. Poor health can be of paramount importance. However, current retirement program policies do not provide incentives for older workers to remain in the work force. In some cases, continued employment is clearly discouraged.

The Commission believes that, in the context of the social security system, the most significant disincentive to continue work is the retirement test. While some people with high earnings and incomes might benefit from the removal of the earnings test, studies have also shown that many people are working to supplement low social security benefits. The current limitation of $5,000 for individuals 65 and over and $3,720 for ages 62 to 64 has encouraged beneficiaries to restrict earnings below those levels.

The Commission has also noted the considerable criticism lodged against the earnings test because it does not apply to nonwork income. This inconsistency is seen by many to penalize earned income.

Therefore, the Commission in its first interim report to the President and Congress has tentatively concluded that if social security benefits are included in income subject to normal taxation, then the earnings test should be eliminated.

Ms. **Ferraro.** Would you repeat that, the first part of that?

Mr. **Woodruff.** Currently workers, when they pay social security contributions or taxes, however you care to characterize them, pay those contributions out of after-tax income. So they are currently paying taxes on the contribution. The Commission proposed in its interim report that in the future—not change the rules for benefits earned currently in the system—but, in the future, have workers defer the taxes that they now pay on their contributions. Thus at the point of retirement or receipt of benefits, the entire benefit would be included as income that would then be subject to the normal tax structure.

If that proposal were adopted, and the Commission recommended that the entire earnings test could be eliminated effectively. You would be replacing the current progressive structure for the somewhat arbitrary 50-percent tax on additional earned income above the earnings-exempt level. In this way we feel both of the problems mentioned in earlier testimony would be reconciled.

Low- and moderate-income people and indeed all people earning below the 50-percent tax bracket would be encouraged to supplement their income through additional work. And high-income workers would have their benefits subject to a high tax rate.

While this recommendation is clearly intended as a long-term solution, it might make sense to raise the earnings limitation in the intervening period. As you are all aware, the limitations have been raised recently, and it may make sense to adopt a proposal where the limitation would be raised to something close to one-half of the average wage for full-time workers. Keying the level to wages would also provide some degree of indexing of the level in the future.

Liberalization in the intervening period could also lead to more positive attitudes towards increased work, prior to the point at which such participation will become critical to our retirement programs. The net cost to the social security trust funds, the Treasury, and to retirees of this recommendation is somewhat complex. And we have begun the process of studying this and have asked the assistance of the Treasury. As soon as these findings are available, we will send them to the committee.

I have some additional points about additional work incentives and alternative work patterns for the elderly, which I will not go into, and I guess let Mr. Pellechio or the next person speak instead.

[The prepared statement of Mr. Woodruff follows:]

PREPARED STATEMENT OF DR. THOMAS C. WOODRUFF, EXECUTIVE DIRECTOR, PRESIDENT'S COMMISSION ON PENSION POLICY

Mr. Chairman, members of the Committee. I appreciate the opportunity to testify before the Committee today on the issue of the social security earnings test and the importance of encouraging able older employees to remain in the labor force.

As you know, the President's Commission on Pension Policy was established out of a recognition that there are some significant problems ahead for pensions. The Commission is developing long-range retirement income policies to deal with these problems.

Our work focuses on the central question of how to provide older Americans with an adequate level of income in their later years. While employment is not generally considered a pension issue, the Commission believes it will become increasingly important in the retirement income context as the nation's population ages.

We are all aware that the country's retirement income resources, both public and private, are straining to meet current benefit payments. We can expect that, unless steps are taken to alleviate this situation, even more pressure will be exerted on these resources in the future.

By 1975 social security assumed payment of approximately 60 percent of all retirement and survivor benefits. State and local government plans and private plans lag far behind. A poll sponsored by the Commission indicates that approximately 58 percent of all workers expected social security to be their primary source of retirement income. And, a joint survey by the Department of Labor and the Social Security Administration indicate that in 1979, only 51 percent full time of workers in private industry were covered by a pension. Half of those workers are vested and therefore eligible for a pension benefit from their current employer.

The Commission endorses the current role of social security in providing a minimum floor of protection for workers and their families. But, we are very concerned about the obvious increase in dependency on pay-as-you-go retirement systems. The 1980 Annual Report of the Social Security Trust Funds released last week reinforces the Commission's conclusion that this nation may face substantial risks by increasing dependence on pay-as-you-go systems.

The mounting pressures on social security brought about by demands for increased pension benefits, high rates of inflation and a larger aged population which lives longer in retirement, make it essential that policymakers examine every option for providing additional income resources to the elderly.

The Commission feels strongly that one way of relieving the intergenerational dependence and financial strain on our retirement systems would be to encourage continued labor force participation.

Over the last several decades, an increasing number of males in the 65+, 60-64 and 55-59 age categories have retired. Although early retirement under social security was provided for males in 1961, the largest drop in labor force participation in the 60-64 age category occurred in the seventies. In 1979, only 62 percent of this group were in the labor force compared with 75 percent in 1970 and 78 percent in 1960. The proportion of women aged 60–64 also dropped in the seventies, although still above the 1960 and 1950 figures. Older women have been experiencing a counter trend of increased participation.

The Commission recognizes there are many factors which enter into the retirement decision, including: health status; anticipated retirement income, and relationship of the worker to the job. Poor health can be of paramount importance. However, current retirement program policies do not provide incentives for older workers to remain in the work force. In some cases, continued employment is clearly discouraged.

The Commission believes that, in the context of the social security system, the most significant disincentive to continue work is the retirement test. While some people with high earnings and incomes might benefit from the removal of the earnings test, studies have also shown that many people are working to supplement low social security benefits. The current limitation of $5,000 for individuals 65 and over and $3,720 for ages 62–64 has encouraged beneficiaries to restrict earnings below those levels.

The Commission has also noted the considerable criticism lodged against the earnings test because it does not apply to nonwork income. This inconsistency is seen by many to penalize earned income.

Therefore, the Commission in its first interim report to the President and Congress has tentatively concluded that if social security benefits are included in income subject to normal taxation, then the earnings test should be eliminated. In this way, both problems are reconciled: low income people would be encouraged to supplement their income through work, and high income people would have their benefits subject to a high tax rate.

While this recommendation is clearly intended as a long-term solution, it might make sense to raise the earnings limitation in the intervening period. Congress has recently amended the earnings test provisions to increase to $6,000 in 1982 for those over age 65, with periodic adjustments tied to increase in wage levels thereafter. Further liberalization—perhaps to a point equal to about one-half of the average wage for the full time work force might increase part-time work effort by those age 65+. Liberalization in the intervening period could also lead to more positive attitudes toward increased work force participation prior to the point at which such participation becomes critical.

The net costs to the Social Security Trust Funds, the Treasury, and retired individuals of the Commission's recommendations and/or liberalization must be carefully studied. The Commission is currently determining the impact of its tentative recommendations.

While it is somewhat beyond the specific topic of this hearing, I would like to briefly mention disincentives that exist in other programs.

Retirees with private or public pensions sometimes are prohibited from engaging in work similar to that performed for the employer before retirement or have their pensions reduced or cancelled. In the federal government, retirees who are employed by the government have their pay reduced by the full amount of the annuity received.

Alternative work patterns such as part-time work, staggered work hours and sabbaticals have been suggested. Such alternatives also would benefit those who have retired from one job and desire part-time work after retirement. Some firms have tried such approaches on a limited basis. In a case study of a firm which has reduced work programs for persons aged 60–65, it was found that those who participated postponed retirement. The federal government also has a program to provide the opportunity for reduced work hours for older persons.

These are problems with implementing such programs, however. Supervisors may not be able to participate without taking a nonsupervisory job, for example. Other loses of status may occur. In addition, an important consideration is the effect on pension benefits. Part-time work means a reduction in pay, and pension benefits are commonly based on recent pay levels in defined benefit plans. Thus, part-time work in the years before retirement could reduce pension benefits.

The Commission believes that information on alternative work patterns should be encouraged and developed through research and demonstration programs in existing federal employment programs. Alternative patterns would include part-time employment including job sharing and mini-shifts, flexible hours of work and phased retirement.

The Commission further agreed that job retraining and job redesign for older workers in private industry should be encouraged through tax incentives, federal employment and training programs and/or federal contract requirements.

In summary, income from employment is not as significant as source of support for the elderly as it was in the past. It is unsettling to note that this trend may continue in the future. While two thirds of the respondents to the Commission's survey indicated they do not expect their pensions to be adequate for their needs, and 58 percent expect continued high inflation, almost 48 percent expect to retire at or before age 62.

Given the growing problems caused by an aging population and steady inflation, older workers should be encouraged to remain in the work force to add to their retirement income.

STATEMENT OF ANTHONY J. PELLECHIO

Mr. PELLECHIO. I want to thank the committee for this opportunity to present and discuss evidence that the social security retirement test has the effect of reducing the earnings of retirement-age workers. The retirement test is supposed to lower benefit payments to individuals whose earnings exceed an exempt amount. However, my earlier research on the retirement test led me to conclude that retirement-age workers held their earnings below the earnings-exempt amount in order to receive their full benefit payment. My work also showed these workers would increase their earnings if the exempt amount were raised. As a result of this behavior, payroll tax revenue collected by the social security system is reduced. An implication of this work was that there should be a high concentration of workers who earn just below the earnings-exempt amount, and whose earnings move up with the exempt amount over time.

In order to examine whether this occurs, I constructed earnings distributions for workers age 65 to 71. These individuals are eligible for full retirement benefits subject to the retirement test. Table 1 of my written testimony gives the percentage of workers in $100 earnings brackets for each year from 1966 through 1975. The tables are at the end of the written testimony.

The earnings bracket just below the exempt amount in each year is underlined. The percentages in this $100 bracket just below the exempt amount are high relative to percentages in other brackets in all years. What is particularly significant is how the percentage drops going from the bracket just below the exempt amount to the bracket just above. In 1968 through 1972 the exempt amount remained at $1,680 and the percentages in the $1,601 to $1,700 bracket rise steadily from 6.5 to 9.5 percent over that period while the percentages in the bracket immediately above stayed around 1.9 percent.

Figures 1 and 2 which were handwritten and handed out separately from the written testimony, and I hope you have, illustrate the earnings distributions for 1972 and 1973. Figure 1 gives a graphic illustration of how individuals hold their earnings to no more than the exempt amount of $1,680 in 1972. There is a striking concentration or cluster of people in the $100 bracket at this exempt amount; 9.5 percent of workers age 65 to 71 held their earnings in this narrow earnings bracket. As mentioned, the exempt amount stayed at $1,680 for 5 years through 1972. Despite the increasing concentration of workers earning this exempt amount over these 5 years, as soon as the exempt amount rose to $2,100 in 1973, the cluster moves up with it. This is illustrated in figure 2.

These two figures illustrate for 1972 and 1973 what is documented in table 1 for every year from 1966 through 1975, which is that the earnings distributions of retirement-aged workers is highly distorted by the earnings test.

There is a marked high concentration of workers holding their earnings below the exempt amount.

The fact that in 1972 9.5 percent of the workers had earnings in the $100 bracket just below the exempt amount while 14.9 percent earned $9,000 or more is particularly significant. Clearly retirement-age workers are holding their earnings below the exempt amount in order to receive this full benefit payment. Therefore for these workers the retirement test does not reduce their benefit but rather makes them reduce their earnings. In other words, the social security system does not save money through lower benefit payments, but loses revenue because of forgone payroll tax revenue.

Let us see how this is indeed what happens from another angle. For the years in which the exempt amount changed table 2 in my written testimony reports the percentage increases in the exempt amount and the percentages increased in total earnings of 65 to 71 year old workers who earn the exempt amount or less. As table 2 shows, total earnings of these workers go up with the exempt amount. For example, in 1973 total earnings below the exempt amount went up by 30 percent when the exempt amount was raised by 25 percent to $2,100 after remaining at $1,680 for the previous 5 years. As workers increase their earnings to follow the exempt amount, they still receive their full benefit payment. So the social security system pays no more in benefits to these workers.

In my written testimony I make a rough statement that the total earnings of workers earning below the exempt amount today is $2 billion. If the exempt amount of $5,500 in 1981 were raised by 50 percent to approximately $8,000 and total earnings went up by the same percentage, there would be a $1 billion increase in these earnings. At a combined employer and employee payroll tax rate of 13.3 percent in 1981, the social security system would collect an additional $133 million from workers earning no more than the exempt amount. This is a $133 million increase in payroll tax revenue with no associated increase in benefit payments to those generating the revenue.

These predictions are of course approximations. But the fact that the payroll tax revenue will be raised as a result of behavioral responses to an increase in the exempt amount is obvious from the evidence. This evidence clearly supports a substantial increase in the exempt amount of the retirement test or elimination of the retirement test entirely.

As the age distribution of the population shifts, the continued labor force participation of older workers will be an important input to aggregate supply. There should be no disincentives to their participation in economic activity.

Thank you.

[The prepared statement of Mr. Pellechio follows:]

PREPARED STATEMENT OF ANTHONY J. PELLECHIO, UNIVERSITY OF ROCHESTER, AND NATIONAL BUREAU OF ECONOMIC RESEARCH

THE EFFECT OF THE SOCIAL SECURITY RETIREMENT TEST ON THE EARNINGS OF RETIREMENT AGED WORKERS

Mr. Chairman, the purpose of this testimony is to recommend reform of an important provision in the social security program. This provision, called the retirement test, reduces an individual's social security retirement benefit payment when his earnings exceed a certain amount. The earnings level allowed before the reduction in benefit payment is called the exempt amount. The retirement test was intended to direct benefit payments to individuals whose retirement was outside their control and had reduced there income. However, the retirement test implicitly measures an individual's retirement by his earnings which are subject to his control. As a result, the retirement test imposes a high implicit tax in terms of foregone benefit payments on earnings above the exempt amount. Consequently, the retirement test may induce individuals to keep their earnings below the exempt amount in order to receive their full benefit payment. Evidence that the retirement test does just that will be presented here. Recommendations for evaluating changes in the retirement test follow from this evidence.

Currently the retirement test reduces benefit payments by $0.50 for every dollar of earnings above the exempt amount of $5,000. Benefit reduction continues until benefit payments are reduced to zero. A useful way to discuss how the individual is affected by the retirement test is in terms of how it affects his net wage. Up to the exempt amount an individual's net wage equals his full wage. Of course, income taxes other than the retirement test will determine what is meant by full wage here. For the purposes of this discussion, full wage can subsume whatever other adjustments should be kept in mind but will not be considered explicitly. In other words, other income taxes do not affect the points being made here. Above the exempt amount the individual's net wage equals half of his full wage. Another way to say this is that the retirement test has an implicit tax rate on earnings above the exempt amount of 50 percent. At the point where benefit payments are reduced to zero the individual's net wage returns to his full wage.

The economic approach to studying how the retirement test affects earnings would be to estimate a model describing how many hours people work. Such a model of labor supply involves expressing hours of work as a function of net wage and other characteristics of the population and market. In the presence of the retirement test, a person's net wage changes as described above. This poses significant problems for estimating labor supply. Such estimation is a formidable econometric task and has been the subject of recent econometric studies by me and others.

In my early work on the econometrics of labor supply estimation, I applied some of my techniques to the retirement test. My purpose here is not to describe my econometric methodology. Nor will there be much emphasis on my earlier empirical results. These results will be described only qualitatively in order to provide a foundation for the evidence presented here.

My econometric specification was designed to permit the empirical study of how individuals respond to the exempt amount and implicit tax rate separately. This distinction is extremely important from a policy point of view. The reason is that individuals' net wages can be increased either by raising the exempt amount or lowering the implicit tax rate. However, if individuals respond differently to changes in the exempt amount and changes in the implicit tax rate then effects of apparently equivalent ways to relax the retirement test will differ. My empirical results show that individuals are much more responsive to the exempt amount than to the implicit tax rate. The estimated labor supply model predicts that individuals will increase their earnings if the exempt amount is raised, but not if the tax rate is lowered.

There are two reasons why lowering the implicit tax rate of the retirement test does not necessarily raise labor supply. First, the tax rate may be high enough so that no one has earnings in the range where benefits are reduced. In other words, everyone is either earning below the exempt amount or earning enough so that benefit payments are reduced to zero. The tax rate at which you just get such a dichotomy in behavior is called the critical tax rate. My simulations may have only lowered the tax rate to a level that was still above the critical tax rate. Second, when the tax rate is lowered, earnings are taxed over a wider range, for example, it takes a higher level of earnings to reduce benefits to zero. Thus, an individual's net wage does not necessarily go up because the range for receiving full wage is smaller.

It is worthwhile to go over the ambiguous effect of changing the implicit tax rate not so much for explaining my results as for pointing out things that should be considered when making reforms. In this spirit, it is important to mention that raising the exempt amount can have ambiguous effects in the theoretical analysis of the retirement test. In short, theory does not predict whether people will earn more or less when the exempt amount is raised or the implicit tax rate is lowered. My empirical results provide preliminary evidence that raising the exempt amount increases earnings while lowering the implicit tax rate does not. But this is not the evidence for today's discussion.

An implication of my earlier results was that there should be a high concentration or cluster of people earning just below the exempt amount. Consequently, an empirical study to follow up my econometric estimation of labor supply is simple. It involves looking at earnings distributions for retirement aged persons in years when the exempt amount assumed different values and seeing whether there is a high concentration of people earning just below the exempt amount. In other words, we look to see if people's earnings "follow" the exempt amount as it changes over time. Also, the earnings distributions of retirement aged persons who are not subject to the retirement test should be checked to see that high concentrations at the exempt amount do not occur; otherwise, the results would be spurious.

The social security program provides the opportunity to carry out both of the above examinations. First, the exempt amount was changed over time in a highly irregular way. Consequently, evidence of high concentrations of people earning just below the exempt amount would support the conclusion that people keep their earnings below the exempt amount in order to receive their full benefit payments. Secondly, the retirement test applies to persons age 62-71 years old, but not to persons age 72 and over. The earnings distributions of 72 year olds and over should not show high concentrations just below the exempt amount. If this does happen then it would be difficult to draw any conclusions about the retirement test.

A rich file of data from the Social Security Administration is used to construct earnings distributions here; this file is the 1973 CPS-IRS-SSA Exact Match file. The file starts with the March 1973 Current Population Survey (CPS). Each individual's CPS record is matched to extracts of his 1972 income tax return (IRS) and social security records (SSA). The SSA data include annual earnings from 1966 through 1975. The sample used here consists of persons age 65 years old and over whose earnings were positive in any year from 1966-75. Individuals are eligible at age 62 for early retirement benefits. But early retirement benefits are less than full benefits for retirement at age 65. Also, benefits that are not collected before age 65 are counted toward an actuarial increase in the benefit payment at age 65. Thus, any reduction in benefit payments due to the retirement test between ages 62-64 may be cancelled by actuarial increases in future benefits. For this reason, the sample was choosen to be retirement aged workers who are eligible for full benefits, i.e. workers age 65 and over.

Table 1 presents the distribution of 65-71 year old workers by earnings in $100 brackets for each year from 1966 through 1975. The exempt amounts in these years were $1,500 in 1966-67, $1,680 in 1968-72, $2,100 in 1973, $2,400 in 1974 and $2,540 in 1975. The percentage of workers whose earnings are in the $100 bracket just below the exempt amount is underlined for each year. These percentages in all years are high relative to the percentages in other brackets. What is particularly significant is how the concentration of workers drops going from the bracket just below the exempt amount to the bracket just above. The distributions in Table 1 suggest that workers reduce their earnings to avoid the retirement test.

The pattern of changes in the distributions is strong evidence that workers reduce their earnings to just below the exempt amount. In 1966-67 the percentage of workers earning just below the exempt amount of $1,500 increased from 5.5 percent in 1966 to 6.3 percent in 1967. In 1968 the exempt amount was raised to $1,680 and the cluster moves up to the bracket just below the new amount. From 1968-72 the exempt amount stayed at $1,680 and the earnings distribution became more concentrated at that amount. The percentages rise steadily from 6.5 to 9.5 percent in the $1,601-1,700 bracket while the percentages in the bracket immediately above stayed around 1.9 percent. Although the distribution became more concentrated at the exempt amount in 1968-72, as soon as it was raised in 1973 to $2,100 the cluster moved up with it. This happens again in 1974 and 1975. (In 1975 with an exempt amount of $2,540 the cluster gets spread over the $2,401-2,500 and $2,501-2,600 brackets.)

The 1973 Exact Match file reports earnings only up to the maximum earnings taxable under social security. The percentages of workers in brackets above $3,000 up to the maximum taxable earnings (MTE) are less than 1 percent in all but a few brackets and average less than one-half percent. The percentages in the bracket denoted MTE are the percentages of workers who earn the maximum taxable earnings or more. The total sample population in each year is given at the bottom of the table. The sample population in any bracket can be calculated from the percent-ge and total. The overall picture from Table 1 is that workers either keep their arnings low enough so as not to lose any benefit payments or earn the maximum axable earnings or above.

For the years in which the exempt amount change Table 2 reports the percentage ncreases in the exempt amount and in total earnings of 65–71 year old workers who arned the exempt amount or less. As the table shows, total earnings of these vorkers go up with the exempt amount. This is expected given the evidence in able 1 showing that workers tend to be concentrated in the bracket just below the xempt amount. The 1974–75 recession was probably responsible for the small ncrease in total earnings in 1975. In fact, given the severity of the recession, it is robably noteworthy that total earnings of retired workers went up at all when the xempt amount went up (note the decrease in the population of 65–71 year old vorkers in 1975 in Table 1).

Benefit payments to workers who earn the exempt amount or less do not change vhen the exempt amount is raised. As these workers increase their earnings to ollow a new exempt amount they still receive their full benefit as they did before. o the social security system pays no more in benefits to these workers due to the ncrease in the exempt amount, but collects more payroll tax revenue on their ncreased earnings.

Total earnings of 65–71 year old workers earning the exempt amount or less were pproximately $1 billion in 1969 in the sample used here. Given the increase in vages in the last decade total earnings of such a sample of workers today would be bout $2 billion. If the exempt amount in 1981 were raised by 50 percent to pproximately $8,000 and total earnings in this sample went up by the same ercentage, there would be a one billion dollar increase in these earnings. At a ombined employer and employee payroll tax rate of 13.3 percent in 1981 the social ecurity system would collect an additional $133 million from workers earning no nore than the exempt amount. These workers would continue receiving benefits as hey did before. In other words this is a $133 million increase in revenue from vorkers whose benefit payments will not be affected by the change.

As mentioned before the presentation of empirical results, the earnings distribuion of 72 year olds provide additional evidence that the relationship between the etirement test and earnings of retirement aged workers is a causal relationship nd not a spurious correlation. Because workers age 72 and over are not covered by he retirement test there should not be any clustering of the kind that was found bove for 65–71 year old workers. Table 3 presents the earnings distributions for 72 ear olds and over in the same way as was done for 65–71 year olds in Table 1. The 100 earnings bracket just below the exempt amount is underlined for each year. As an be seen, there is no clustering of workers in these brackets. This is significant n its own and also because there is considerable overlap between the samples in ables 1 and 2. For example, a person age 67 in 1966 is in the sample for Table 1 in 966–70 and in the sample for Table 3 in 1971–75. Consequently, the conclusions bout behavior that are drawn from Tables 1 and 3 come in part from observing hanges in behavior of the same people.

I believe the earnings distributions for retirement aged workers have been examned carefully to see whether the retirement test affects earnings. It is clear that he retirement test makes workers subject to it hold their earnings below the xempt amount in order to receive full benefit payments. The predictions the mount by which payroll tax revenue would go up if the exempt amount is raised re approximations, but the fact that payroll tax revenue will be raised as a result f behavioral responses to such a change is obvious from the results.

The effects of the social security retirement test on earnings of retirement aged vorkers is one important way in which social security can affect individual behavor. The suggested reform is consistent with a much broader program of reform. It is mportant to put the issue and reform discussed here in the context of the broad picture.

The social security system has two objectives: (1) the reallocation of an individual's lifetime income to later years in order to provide support for his own retirement; and (2) the redistribution of income between individuals in order to provide upport that is adequate according to standards set by society. The present system epresents an effort to meet both objectives through a single benefit formula and payroll tax structure.

Social security can affect behavior because the relationship between payroll taxes and benefit payments is tenuous. If an individual's benefit equalled the annunity that his payroll tax contributions (plus accumulated interest) would provide, then social security would not change the lifetime income of an individual. Social security would function like an annuity and provide retirement income in a way that achieves individual equity. In other words, the reallocation objective can be met without there being any change in lifetime income; a person can always expect to receive in future benefits what he pays in payroll taxes (or pays in foregone benefits by retiring later). Also, social security would always be in actuarial balance by definition.

The other objective of social security—social adequacy—causes the program to depart from individual equity. As mentioned, this objective stipulates that adequate retirement income be provided according to some standard. As a result, individuals with low lifetime income receive benefit payments whose present value exceeds the accumulated value of the payroll taxes they paid into the system. This extra income comes from individuals with higher lifetime earnings for whom the present value of benefits falls short of the accumulated value of payroll taxes. Social security cannot achieve both an actuarially fair reallocation of lifetime income for all individuals in order to support their retirement, and a redistribution of income between individuals to make sure that support is adequate.

The social security system is under constant re-evaluation in the public forum by decree of law and because of the financial difficulties confronting the system of which the general public is increasingly aware. Because the income tax system is the proper place for income redistribution, the income redistribution done by social security, for example, the cost of meeting the objective of social adequacy, should be financed from general revenues. A single program of income maintenance that combines all forms of income support currently spread over a wide variety of programs including social security can provide socially adequate support based on lifetime earnings. An important implication of this is that poverty would not be misrepresented as a problem of the aged.

The main task of social security would be to reallocate individuals' lifetime incomes to provide retirement income in an actuarially fair way. In other words, social security would meet the reallocation objective and achieve individual equity. The program would become a public pension system that functions like an annuity. It would not alter the opportunities of any individual and, as a result, not distort individual behavior. In a sense, social security would be subject to rules implied by the spirit of the pension reform legislation of 1976.

It is important to emphasize that this recommendation in no way suggests an arbitrary draw on general revenues to maintain the currently operating system. Rather the recommendation requires a careful accounting of how the current system works and what the costs of meeting the reallocation and adequacy objectives are. Such accounting is worthwhile on its own as a way of telling policymakers and the public exactly what is going on. Such accounting is a prerequisite for the task of deciding how to structure the social security system that society faces.

The potential effects of social security on individual behavior is a relevant issue in social security policy. At present, through a complicated benefit and tax structure, social security tries to meet conflicting objectives at once which confuses the issues and causes problems. There are many gains from meeting these objectives separately. The financial status of social security will be improved. Individuals will be able to make undistorted decisions about their lifetime consumption, earnings, and retirement. As the age distribution of the population shifts, the continued labor force participation of older workers will be an important input to aggregate supply. There should be no disincentives to their participation in economic activity.

[See appendix 3, p. 183 for attachments to Mr. Pellechio's prepared statement.]

Ms. FERRARO. Mr. Hacking.

STATEMENT OF JAMES HACKING

Mr. HACKING. Let me submit the organization's statement for the record. I have a summary of that statement. And I have edited that summary down in the interest of time.

Let me begin by saying I am delighted to be on this panel rather than the preceding one. I would not want the positions of the NRTA and the AARP in any way associated with or tainted by the major proposals that Mr. Penner advanced, especially his proposal to substitute price indexing of earnings records for the current wage indexing procedures in the computation of social security benefits. Those proposals I think would seriously jeopardize the already poor income situation prospects of the future elderly population of this country.

th that said, I would like to proceed to my summary and I d like to begin by describing some of the results of a study was done for our associations by Data Resources Inc. on the and future impacts of inflation on the elderly so that we can nto perspective what we feel is the urgent need to encourage present and future generations of elderly persons to maximize work effort.

to the elderly's income status, the study concluded that al- gh average elderly incomes have generally kept pace with tion over the decade 1967–1977, the decade of the 1980's will a relative, real and significant decline in their standards of g because of the continuation of inflation. To explain the elder- ability to keep pace over the past decade, the study points to obvious: that beginning around 1965 there was enormous ex- ion and growth in terms of public programs. Social security expanded; new programs were put into place, like medicare medicaid; SSI came in in the early 1970's; we had housing rams developed and the food stamp program came on line. e end result of this was that the elderly not only kept pace inflation but made real gains. They did so absolutely and ive to the nonelderly.

t in the current and foreseeable economic climate, we cannot stically expect to see costly expansions of programs and the tions of new and costly programs. We can, however, realistical- xpect to see inflation rapidly erode those components of the ent elderly generation's income which are unprotected or inad- tely protected against inflation, like for example the income private pensions or the income from savings and other me-producing assets.

e implications of this are quite significant.

hile we have managed over the past decade to improve the 's income status and reduce poverty among them, the inflation d is offsetting that progress by severely constricting the real me received from private sources.

hile the growth and expansion of Government programs have ght lower income elderly up from the bottom of the income e since 1965, the inflation trend is in the process of pushing the rly down from the top. The result is that the elderly are easingly concentrated in the lower reaches of the income distri- on, just above the poverty line.

is clear that to provide the elderly with increased compensa- for inflation and reverse this deterioration in their income, we ot expect to rely on Government income support programs, social security, since this program and others like it are al- ly under severe financial strains. And for the longer term, ographic trends will make any expansion or improvement of e Government programs virtually impossible.

or these reasons, Government must do all it can to reduce the ee of elderly dependence on Government income support pro- ms by encouraging them and rewarding them to rely on their efforts to gain income from other sources, especially employ- t, to meet their total income needs.

the face of the inflation trend and future demographic trends, our belief that employment offers both the current and future elderly the best, and maybe one of the only, means to prevent a deterioration in their income status. To make employment a viable option for the elderly, many changes will be required in mandatory retirement laws, the tax laws, and the entire Government income support structure. However, the single action of abolishing the social security earnings limitation will be a necessary first step since it is a major work disincentive to the elderly.

Our association wants the limit abolished as a first step for persons 65 and older, because we are convinced the earnings test is, in the aggregate, costing society more now than it would cost the social security program if it were removed, and will cost even more in light of future economic and demographic trends.

One reason why some oppose eliminating the earnings test is that they want the nature of social security to remain static. This attitude is shortsighted. Fundamental change in the nature of the system is what is needed if we are going to avoid having it become overwhelmed by the cost consequences of obvious demographic, economic, and labor-force participation trends. We believe social security must respond to these trends and be transformed into a system the benefit and financing structures of which encourage and reward work effort.

This incentive approach to encourage work effort will greatly help to accommodate the demographic trend and is clearly preferable to such drastic measures as raising the age to 68 for receipt of full benefits.

Not only should work disincentives like the earnings test be abolished, work incentives within social security are also required. For example, to encourage persons to continue to work past 65 and elect to delay applying for benefits, benefits should be increased actuarially for each year application is delayed after age 65.

Other actions that must be taken include: elimination of mandatory retirement, better enforcement of the age discrimination in employment laws, expansion of existing or creation of new Government training and employment programs specifically targeted on older workers, and changes in the Federal tax structure to provide incentives to employers to hire older workers.

In view of the economic and demographic trends, it should be apparent that Government policies which create incentives for early labor-force withdrawal are imposing serious and unnecessary costs on our economic system and are making it more and more difficult for older persons to maintain adequate standards of living in their later years.

Given what we hope is a commitment on the part of Congress to the maintenance of reasonable levels of income among the elderly, any share of that income which can be generated through the work effort of willing older persons represents a share that need not be borne by public programs and younger taxpayers who support them. Clearly, additional work opportunities benefit older individuals as well, raising their standard of living, providing them with a greater feeling of independence and self-determination, and improving their prospects for maintaining their living standard in the face of serious and continuing inflation.

Just as clearly, the Nation as a whole would benefit from the gains in national income and tax collections that would result from ur getting the most from our previous investment in the training, ducation, and experience embodied in older persons.

Thank you, Mr. Chairman, for letting me present those views.

[The prepared statement of the National Retired Teachers Assoiation/American Association of Retired Persons, submitted by ames Hacking follows:]

PREPARED STATEMENT OF THE NATIONAL RETIRED TEACHERS ASSOCIATION AND THE AMERICAN ASSOCIATION OF RETIRED PERSONS, PRESENTED BY JAMES HACKING

THE NEED TO ABOLISH THE SOCIAL SECURITY EARNINGS LIMITATION

INFLATION AND THE NEED FOR ELDERLY EMPLOYMENT

"Inflation and the Elderly" is the subject of a recently released study which was sponsored by NRTA-AARP and conducted by the econometric firm of Data Resources, Inc. (DRI). The study analyzed the impact inflation has had over the past decade and will have over the next decade on the elderly's income, expenditures and net worth. Our Associations would like to briefly present the results of this study so that we can put into proper perspective the overwhelming need for government to encourage the present and future generations of elderly persons to maximize their work effort. The social security earnings limitation, along with other disincentives and barriers to elderly employment must be removed as a first step toward achieving that goal. In the face of the inflation trend and future demographic trends, it is our belief that employment offers both the current and future elderly the best--and perhaps the only--means to prevent a deterioration in their income status.

With respect to the aged's income status, the DRI study concludes that although average elderly incomes have kept pace with inflation over the past decade (1967-1977), the next decade will see a diminution of the elderly's relative income share and a decline in their standards of living because of the expected persistence of inflation. To explain the elderly's ability to keep pace over the past decade, the study points to large, ad hoc increases in social security benefits which were enacted in the late 1960s and early 1970s to address the extremely high incidence of poverty existing among the elderly at that time.

Because such large social security benefit increases will ot be possible in the future, it is expected that inflation ill rapidly erode those components of the elderly's income hich are unprotected from inflation (private pensions, savings, tc.). At the same time, since the elderly concentrate their xpenditures on necessities--food, fuel and medical care--xcessive inflation in these sectors is causing their expenitures to increase at a rate in excess of the overall CPI, hich is the measure used to index the major federal income upport programs.

The public policy implications of these findings are uite significant. While we have managed over the past decade o improve the aged's income status and reduce poverty among hem, a pernicious trend--the inflation trend--is offsetting hat progress by severely constricting the real income received rom sources other than federal government programs--like priate pensions, savings and other assets. In addition, the nadequate cost-indexing of programs like social security, hich fails to take into account the elderly's special expeniture patterns, has been making it increasingly difficult for hem to make ends meet. While the growth and expansion of overnment programs like social security have brought the lderly up from the bottom of the income scale, the inflation trend is in the process of rapidly pushing them down from the top. The result is that they are becoming increasingly concentrated in the lower reaches of the income distribution, just above the poverty line.

It is clear that, to provide the elderly with increased compensation for inflation and reverse this deterioration in their income, we cannot expect to rely on government income support programs, like social security, since this program and others like it are already under severe financial strains. And for the longer term, demographic trends will make any expansion or improvement of these government programs virtually impossible. Indeed we will be finding it increasingly difficult to maintain the current level of support.

For these reasons, government must do all it can to reduce the degree of elderly dependence on government income support programs by encouraging them to rely on other sources of income, especially employment, to meet their total income needs. To make employment a viable option for the elderly, many changes will be required in mandatory retirement laws, tax laws, and the government income support structure. However, the single action of abolishing the social security earnings limitation is a necessary first step. We consider the earnings limit to be the major work disincentive for the elderly.

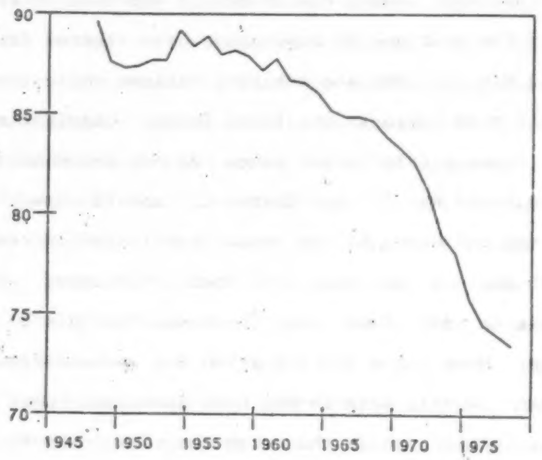
LDERLY LABOR FORCE PARTICIPATION TRENDS

Before discussing the earnings limitation issue, it would e useful to examine elderly labor force participation trends. espite the benefits that greater elderly work effort can ield, current work trends are ominous. Work and retirement atterns of the over age 55 population have altered drastically ince World War II. Men are retiring earlier while there are ncreasingly more women in the labor force. Charts I and II how labor force participation rates for men and women age 5-64 since World War II, and Charts III and IV show those ates for men and women 65 and over. Participation rates for en over 65 are now less than half their 1950 rates. Work orce levels in 1978 of men aged 55-64 are five-sixths of their 950 levels. Work force participation for women differs from hat for men. Women, ages 55-64, have increased their labor orce participation, while the rates for those over 65 have een gradually declining since the late fifties. These rates ave declined steadily over the period and the decline appears o have intensified in recent years.

CHART I

LABOR FORCE PARTICIPATION RATES

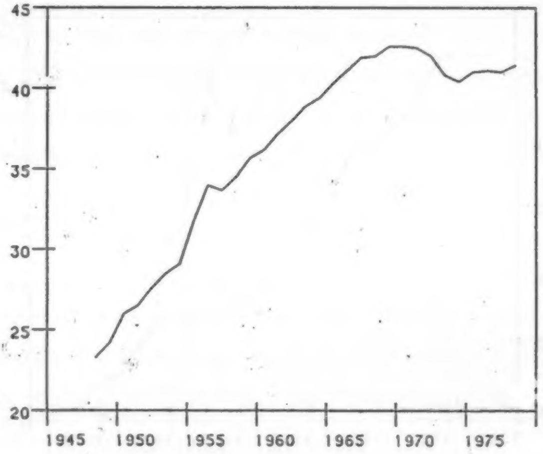
MEN 55-64



Source: Inflation and the Elderly - Part II, report prepared by Data Resources, Inc. for NRTA/AARP. January 1980

CHART II

LABOR FORCE PARTICIPATION RATES
WOMEN 55-64



Source: Inflation and the Elderly - Part II, report prepared by Data Resources, Inc. for NRTA/AARP. January 1980

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earnings of social security beneficiaries and, therefore, the extent to which beneficiaries with gross earnings in excess of the earnings test exempt amount may have net earnings below that amount. Various Federal agencies (including the Social Security Administration (SSA) and the Office of Tax Analysis, Department of the Treasury) and private researchers are in a position to make such calculations. However, the results would be very highly dependent upon assumptions made regarding the age, family composition, other taxable income, etc., of the beneficiary group(s) in question and on assumptions made as to applicable State and local taxes. Given the inherently arbitrary nature of some of these key assumptions, there is a serious question as to how valid such a rough analysis might be for policymaking purposes.

Question 3. Do you feel that this idea of being penalized for paying taxes is unfair?

Answer. We do not believe that using gross earnings (i.e., earnings before Federal, State and local taxes are paid) in determing whether a person exceeds the exempt amount under the social security earnings test is unfair since that is the same basis that is used in crediting earnings for social security coverage and benefit purposes.

Social security has always been viewed as an earnings replacement program. Workers and their dependents are insured against the risk of earnings loss as a result of retirement, disability or death, and benefits are designed to partially replace the earnings that are actually lost. Since the earnings test is used to measure whether a loss of earnings has occurred, we believe it is appropriate that the definition of earnings under the earnings test be as consistent as possible with the definition for crediting earnings.

Earnings for social security purposes, including the earnings test, are earnings before personal or property taxes. It is generally advantageous for beneficiaries to get social security credit on this basis. If amounts paid for taxes were excluded from earnings for benefit-crediting purposes, the benefit amounts payable would be less than under present law. The reduction in benefit amounts that would result for virtually all beneficiaries would outweigh the gain to the relatively few beneficiaries who work and would have smaller amounts of benefits withheld under the earnings test.[1] Also, the amount of earnings credited to an employee and counted for the earnings test would depend on variables unrelated to work. For example, two employees could have the same gross earnings but the one who had higher income tax deductions from salary because he or she had fewer dependents would have a lower salary for social security purposes.

It is true that when State and local taxes are taken into account, in addition to social security taxes and Federal income wages, some beneficiaries may not experience increases in disposable income as earnings exceed the exempt amount, unless earnings exceed that level very substantially. As a practical matter, however, the $1-for-$2 withholding rate under the earnings test represents a substantial improvement over the law in effect before the 1972 amendments. Under that law, as earnings exceeded a specified level above the exempt amount, $1 in tax-free benefits was withheld for each $1 in taxable earnings, so that a person had less income after Federal taxes as earnings increased. As a result of the change to a $1-for-$2 test for all earnings over the exempt amount, beneficiaries generally have some incentive to increase their earnings because, in most cases, the more they earn, the more spendable income they will have.

Question 4. What would you recommend to rectify this inequity in the present system?

Answer. As noted in response to Question 3, the major area in which beneficiaries could generally expect the benefits withheld under the earnings test to exceed their aftertax earnings was eliminated in 1972 with the introduction of a $1-for-$2 withholding rate for all earnings above the annual exempt amount.

However, it is recognized that, in some cases, when State and local taxes are taken into account, beneficiaries may not be better off or may be only slightly better off as earnings increase. The 1975 Advisory Council on Social Security was concerned that, under the $1-for-$2 withholding rate for earnings above the exempt amount, the additional earnings a beneficiary receives over the exempt amount may result in little additional net income. The Council believed that the test might, therefore, be acting to discourage participation in the labor force and recommended reducing the rate at which earnings above the exempt amount would reduce benefits. A copy of the recommendation is attached. The cost of this recommendation was estimated at that time to be 0.04 percent of taxable payroll over 75 years and $0.6 billion in 1976, the first full calendar year.

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[1] Only 9.5 percent of retired-worker beneficiaries under age 72 had some benefits withheld because of the earnings test during 1977 and only 2.5 percent of these beneficiaries had all benefits withheld. (See Question 1, Table 1.)

The 1979 Advisory Council also considered reducing the withholding rate. However, the Council recommended against any change, stating in its report, "that other benefit liberalizations are of higher priority. Just as eliminating the earnings test would help those who need it least, so would reducing the rate at which benefits are withheld when earnings exceed the exempt amount because those with the higher earnings by definition would be helped more."

The Administration also recommends no change in the general provisions for withholding benefits under the earnings test. We do not believe the work disincentive effect under the present test is great enough to justify changing the earnings test at this time. As a result of substantial liberalizations made by the "Social Security Amendments of 1977" (P.L. 95-216), for example, a single worker who reaches age 65 in 1980 and who has lifetime earnings under social security equal to the national average (about $11,440) could have income of $10,862 ($5,862 in tax-free social security benefits plus $5,000 in earnings) before any benefits are withheld under the earnings test. The $10,862 is in addition to any other types of income that are not considered for earnings test purposes; e.g., interest, dividends, rents, pensions, etc. As mentioned in our testimony before your subcommittee on June 26, 1980, the goal of promoting work incentives is only one of a number of sometimes conflicting goals of publc policy. Making additional liberalizations in the earnings test would increase the cost of the social security program. These increased costs would to be met either by raising social security taxes or by deliberalizing benefits. We believe the goal of promoting work incentives must be balanced against the need to limit social security taxes and to offer benefits that are as adequate as possible to those who need them the most.

Attachment.

EXCERPTS FROM THE MARCH 10, 1975 REPORTS OF THE QUADRENNIAL ADVISORY COUNCIL ON SOCIAL SECURITY

SECTION 3. LIBERALIZE PROVISIONS OF THE RETIREMENT TEST

Despite basic agreement with the concept of the retirement test, the Council recognizes that negative consequences arise from its application. Under the present $1-for-$2 withholding rate for earnings above the exempt amount, the additional earnings a beneficiary receives over the exempt amount may result in little additional net income to the worker when allowance is made for the additional effects of Federal income, OASDHI, State, and local taxes, in addition to work-related expenses. Thus, the retirement test discourages work by healthy and able individuals aged 65–71. At the moment there is much concern over unemployment, but recent and current low birth rates will soon cause a decline in the rate of increase in the labor force. The Council is, therefore, concerned with provision of the law which may act to discourage participation in the labor force.

In addition, the burden of the retirement test probably falls most heavily on low-income individuals who do not have access to private insurance, pension plans, savings, or other sources of nonwork income to supplement their social security retirement benefits. Such individuals are most likely to be dependent on additional income from gainful employment to supplement social security benefits after "retirement."

The Council believes that the most appropriate means for mitigating the disincentive effects of the retirement test and the heavy burden it imposes on low-income workers aged 65–71 is to reduce the withholding rate on earnings which are just above the exempt amount. The Council proposes to establish three levels of earnings that would be subject to different reductions in benefits.

The first level would include earnings up to the annual exempt amount as defined in the present law ($2,520 in 1975). As under the present law, no benefits would be withheld from earnings within the first level.

The second level would include earnings between the annual exempt amount under the present law and twice this annual exempt amount ($2,520 to $5,040 in 1975). Earnings within this level would be subject to a withholding rate of $1 for every $3 earned, instead of the present withholding rate of $1 for every $2 earned.

The third level would include all earnings in excess of twice the annual exempt amount under the present law (i.e., $5,040 in 1975). The withholding rate at this level would be, as under present law, $1 in benefits for each $2 of earnings.

The provision of the law which automatically adjusts the exempt amount assures that the second level of earnings, to which the $1-for-$3 withholding rate is applied, will increase in the future as general levels of earnings rise.

The main effect of this liberalization would be a significant reduction in the benefits withheld from individuals who earn between one and two times the annual exempt amount. For example, under present law, a worker who earned $5,040 in 1975 would have $1,260 of social security benefits withheld. Under the Council's proposal, this individual would have only $840 withheld, corresponding to a one-third reduction in the burden of the retirement test. The table below illustrates the effect in 1975 of the proposed reduction in withholding rates for earnings in the second level. The percentage reduction in the amount withheld is greatest at the lower level of earnings, where the needs of social security benefit recipients may be presumed to be greater.

Annual earnings	Withholding under present law	Withholding under proposed liberalization	Percentage reduction in amount withheld
$2,520	0	0	
5,040	$1,260	$840	33.3
7,560	2,520	2,100	16.7
10,080	3,780	3,360	11.1

It is estimated by actuaries of the Social Security Administration that this liberalization of the withholding rate would increase the cost of the program by an average of 0.04 percent of taxable payroll over the next 75 years (about $0.6 billion for months in 1976, the first full calendar year).

Question 5. Do you feel that our solutions would help to rectify the inequity?

Answer. Representative Atkinson suggested that social security law be changed to take into account the Federal, State and local taxes a person pays by either: (1) permitting a person, for earning test purposes, to deduct the taxes he or she pays on earned income and property, or (2) raising the earnings test exempt amount for everyone by the average amount of taxes people pay. We would not support either suggestion because we believe that other inequities would be created.

Both suggestions would increase the cost of the social security program and would benefit only the relatively few social security beneficiaries who now lose social security benefits because they have significant earnings. The increased cost would have to be met by raising social security taxes for all workers or by deliberalizing social security benefits. The first suggestion would also result in additional benefits being paid to people with substantial earnings who also have high tax liabilities from sources of income other than earnings and tend to be the most financially well-off of all beneficiaries. This change would (as discussed below) add substantially to the administrative complexity of the earnings test, a provision that is already difficult to administer.

The second suggestion would not involve administrative problems, but would not achieve the result intended. Increasing the exempt amount to reflect the average taxes paid would not give the desired relief to people whose taxes were above the average. Further, if people increased their earnings in response to the higher exempt amount, their taxes would also increase so that the problem that is perceived would continue to occur but at the higher amount.

The suggestion to deduct actual taxes paid from each person's earnings would be extremely difficult, if not impossible, to administer accurately and efficiently since it would require very close cooperation among SSA, the Internal Revenue Service (IRS) and State and local taxing authorities and the effective exchange of information among essentially incompatible recordkeeping systems. For several reasons, Representative Atkinson's suggestion to ask people to send in their W-2's at the end of each year so that SSA could deduct the taxes paid from gross reported earnings would not be sufficient to determine net income. First, the W-2's only show income and social security taxes withheld from employees; they do not reflect actual income tax liabilities, taxes with respect to self-employment income or other taxes, such as property or sales taxes. Thus, SSA would need copies of each person's Federal income tax return, as well as proof of payment of taxes, in order to determine the amount of earnings subject to the earnings test. Even the income tax return would be insufficient for anyone who did not itemize deductions on the Federal return but chose to take the standard deduction. In these cases, SSA would have to ask the person to submit proof of payment of State and local taxes. Furthermore, whenever a person filed an amended Federal or State tax return for a year, it might also be necessary to adjust the amount of social security benefits paid for that year, which could be several years earlier. Finally, in the case of couples, there would be the problem of separately allocating each spouse's taxes since the Federal income tax is based on the filing unit, and a married couple can file a joint return, while social security treats each earner as an individual. For all of the above reasons, administration of the first suggestion would be very time-consuming and costly for SSA.

Moreover, there is a broader theoretical question whether the operation of the earnings test under the national social security system should: (a) vary from State to State and locality to locality depending upon variations in State and local tax laws; or (b) vary depending upon the amount of taxable income a person may have from sources other than earnings.

SELECT COMMITTEE ON AGING,
SUBCOMMITTEE ON RETIREMENT INCOME AND EMPLOYMENT,
Washington, D.C., July 21, 1980.

Mr. JAMES HACKING,
National Retired Teachers Association/American Association of Retired Persons, Washington, D.C.

DEAR MR. HACKING: Thank you for taking the time to testify before the Subcommittee on Retirement Income and Employment on the Social Security earnings test. Your well substantiated and thoughtful views have helped us to understand the issues surrounding this controversial provision.

After a hearing on a subject as important and controversial as this, I request staff to write a report summarizing the issues and testimony with proposed recommendations for Committee approval. Since staff will be writing a report on the "earnings test", I hope that you will not be inconvenienced if they need to communicate with you further on this matter.

My colleague, the Honorable Eugene Atkinson, has asked me to forward to you a few questions that he was unable to ask at the hearing. These are based on his concerns about the use of gross rather than net income in determining Social Security taxes. I have enclosed his questions and a copy of Mr. Atkinson's statement for your use. Your response by August 6 would be appreciated so that we can complete the hearing record.

Again, we are grateful for you contribution. You will receive a copy of the hearing record and the report as soon as they are available.

Peace and Friendship,

JOHN L. BURTON,
Chairman.

QUESTIONS SUBMITTED BY REPRESENTATIVE EUGENE V. ATKINSON

1. Do you feel that this idea of being penalized for paying taxes is unfair?
2. What would you recommend to rectify this inequity in the present system?
3. Do you feel that our solutions would help to rectify the inequity?

NATIONAL RETIRED TEACHERS ASSOCIATION,
AMERICAN ASSOCIATION OF RETIRED PERSONS,
Washington, D.C., August 14, 1980.

Hon. JOHN L. BURTON,
Chairman, Subcommittee on Retirement Income and Employment, Select Committee on Aging, Washington, D.C.

DEAR CONGRESSMAN BURTON: This letter is in response to questions posed by Representative Atkinson in connection with the Subcommittee's recent hearings on the social security retirement test.

Question 1. Do you feel that this idea of being penalized for paying taxes is unfair?

Answer. The marginal tax rate for a social security recipient who earns above the earnings limitation is extremely high. Depending upon the individual's income, it can be as high as 70 percent when one includes the additional payroll taxes and federal and state income taxes which the individual must pay as well as the 50 percent loss of social security benefits when earnings exceed the ceiling.

This high marginal tax rate operates as a severe work disincentive especially for the low and moderate income elderly. The primary impact of this high marginal tax is not to keep a few high earners off the benefit rolls (as some social security technicians argue), but rather to force a substantial portion of the low and moderate income elderly into retirement. This group of elderly is most affected by the retirement test because they respond directly to the disincentive imposed by the high marginal tax rate. Because they are likely to have a low earnings capacity, they are least able to earn sufficiently above the earnings ceiling to make it worthwhile enough to work and bear the high marginal tax rate. On the other hand, high wage earners are able to earn enough above the ceiling to make work a financially attractive option.

Attitude surveys indicate that persons with low retirement incomes tend to want to return to work more than those with higher incomes.[1] A 1974 Louis Harris survey showed, for example, that 43 percent of persons aged 65 with incomes under $3,000 and who are not working would like to work compared to 31 percent of the retired population as a whole.

Question 2. What would you recommend to rectify this inequity in the present system?

Answer. The obvious solution would be total abolition of the earnings limitation. As an incremental step toward elimination of the test, we suggest substantially raising the ceiling until it is removed entirely. The incremental approach of making large ad-hoc increases in the ceiling is, in our view, preferable to other liberalization approaches, such as the Diamond proposal or the one suggested by Representative Atkinson. Raising the ceiling would *clearly* be perceived by elderly persons as a signal by government that they should increase their work effort. The signals provided by the Diamond proposal are somewhat distorted since it provides stronger work inducements for the "older" elderly (age 68–70) than for the "younger" elderly (age 65–67) and thereby fails to have a major impact on the initial decision to retire. In addition, the Diamond proposal, as well as the Atkinson proposal, would be very complicated to administer and, most important, too complicated for beneficiaries to understand.

In testimony before your Subcommittee on June 26, economist Anthony Pellechio presented results from his empirical study of how persons respond to the exempt amount as compared to how they respond to the 50 percent implicit tax rate on benefits. He found that individuals will increase their earnings if the exempt amount is raised, but not if the tax rate is lowered. These findings reinforce our preference for raising and eventually eliminating the earnings limit.

Question 3. Do you feel that our solutions would help rectify the inequity?

Answer. Although Representative Atkinson's proposal would help to alleviate the inequities somewhat, we believe the elderly would more readily comprehend and therefore respond to (by increasing their work effort) a substantial increase in the ceiling and the eventual abolition of the test.

Sincerely,

JAMES M. HACKING,
Assistant Legislative Counsel.

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[1] Meier Elizabeth "Employment of Older Worker' Disincentives and Incentives". Working Paper prepared for the President's Commission on Pension Policy, April 1980.

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